A TALE OF TWO COMMISSIONS: A COMPENDIUM OF THE COST-BENEFIT ANALYSIS REQUIREMENTS FACED BY THE SEC & CFTC

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I. Introduction

> *It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness . . . it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair, we have everything before us, we had nothing before us . . . .*[1]

In the words of Charles Dickens, it is both the best of times and the worst of times for two financial regulators. On the one hand, Congress has granted enormous power to both of these regulators to overhaul the United States financial system. On the other, these same agencies, which seek to bring Congress's vision to fruition, must comply with judicial commands wrought with muddled jurisprudence.

On July 21, 2010, President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-

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[1] CHARLES DICKENS, A TALE OF TWO CITIES 11 (Running Press 1986) (1859).

Frank" or the "Dodd-Frank Act") into law.[2] When enacted, Dodd-Frank required more than 400 different rulemakings from various federal government agencies.[3] Instead of specifying the precise parameters of reform within the Act itself, Congress delegated this responsibility to myriad regulatory agencies better equipped with the requisite expertise to shape financial reform.[4] For example, in section 712 of Dodd-Frank, Congress required the U.S. Securities & Exchange Commission ("SEC") and the U.S. Commodity Futures Trading Commission ("CFTC") to promulgate rules further defining essential terms involved in the swaps markets.[5] Although Congress demanded the regulation of over-the-counter swaps markets, it was the SEC and CFTC that determined the extent of regulation by defining key terms.[6]

Nearly two and a half years have passed since the enactment of Dodd-Frank, and regulators have only promulgated 67.6% of the prescribed rules.[7] According to Davis Polk & Wardwell LLP, which has tracked the promulgation of new rules under Dodd-Frank, as of February 2013, regulators have only finalized 148 (37.2%) of the required rules.[8] There are many reasons for the slow promulgation of these rules, including budgetary constraints, the purposefully slow

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[2] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), Pub. L. No. 111–203, 124 Stat. 1376 (codified in scattered sections of the U.S. Code).

[3] THE FIN. SERVS. COMM., ONE YEAR LATER: THE CONSEQUENCES OF THE DODD-FRANK ACT 1 (2011), *available at* http://financialservices.house.gov/UploadedFiles/FinancialServices-DoddFrank-REPORT.pdf; *see also* CURTIS W. COPELAND, CONG. RESEARCH SERV., R41472, RULEMAKING REQUIREMENTS AND AUTHORITIES IN THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT 4 (2010), *available at* http://www.llsdc.org/attachments/files/255/CRS-R41472.pdf.

[4] *See* Copeland, *supra* note 3, at i, 9; *see also* Larry Alexander & Saikrishna Prakash, *Delegation Really Running Riot*, 93 VA. L. REV. 1035, 1036 (2007).

[5] Dodd-Frank Act, Pub. L. No. 111–203, § 712(d)(1), 124 Stat. 1376, 1644 (codified at 15 U.S.C § 8302(d)(1)).

[6] *See generally* Registration of Swap Dealers and Major Swap Participants, 77 Fed. Reg. 2613 (Jan. 19, 2012) (to be codified at 17 C.F.R. pts. 1,3,23, & 170).

[7] *Dodd-Frank Progress Report*, DAVISPOLK, http://www.davispolk.com (follow "Practices" hyperlink; then follow "Dodd-Frank Resources Center" to access the February 2013 report PDF) (last visited Mar. 18, 2013).

[8] *Id.*

notice and comment rulemaking process, a burgeoning bureaucracy, and uncertainty in the law itself.[9]

While all of these predictable factors have reduced the efficacy of this approach, there remains another hurdle, which Congress did not anticipate, that will challenge the legitimacy of the rules and regulations established under Dodd-Frank.[10] The delegation of rule-making to the SEC and CFTC sounds good in theory,[11] but Congress failed to consider the effect that applicable cost-benefit analysis requirements will have on the long-term viability and legitimacy of the new Dodd-Frank rules.[12]

Petitioners are using cost-benefit analysis requirements to attack new rules and regulations, and are asking courts to render rulemakings "arbitrary and capricious" because of the SEC and CFTC's alleged failure to adequately consider the economic consequences of their adoption.[13] Consequently, decisions striking down rules and regulations as arbitrary and capricious have created tremendous uncertainty for the Commissions as to how they should conduct a cost-benefit analysis that will withstand judicial scrutiny.[14]

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[9] Glenn Hubbard & Hal S. Scott, *Geithner's Hollow 'Speed' Pledge to Business*, WALL ST. J., Aug. 5, 2010, at A17; *see* Harry E. Payne, Jr., *Regulatory Reform: An Administrator's Viewpoint*, 31 WAKE FOREST L. REV. 789, 797 (1996).

[10] *See* Michael J. McFarlin, *CFTC Sued on Position Limits*, FUTURES MAGAZINE, Jan. 1, 2012, http://www.futuresmag.com/2012/01/01/cftc-sued-on-position-limits (Jan. 1, 2012) (recounting how the day before the CFTC filing, Treasury Secretary Timothy Geithner warned of "efforts to use cost-benefit analysis as roadblocks to reform, and other efforts to slow the pace of implementation of regulation in the hopes of watering it down").

[11] While Dodd-Frank requires the promulgation of rules by several regulatory agencies, the focus of this paper is solely on the CFTC and SEC.

[12] *See generally* McFarlin, *supra* note 10.

[13] *E.g.*, Complaint at 11–15, Chicago Mercantile Exchange, Inc. v. CFTC, No. 12-cv-01820 (D.D.C. Nov. 8, 2012), 2012 WL 5457468, *available at* http://www.lfblaw.com/wp-content/uploads/2012/11/CME-v.-CFTC.pdf; *see* SUSAN BERSON & DAVE BERSON, THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT: FROM LEGISLATION TO IMPLEMENTATION TO LITIGATION 279-80 (2012) (discussing how Business Roundtable and the U.S. Chamber of Commerce successfully challenged the SEC's promulgation of Rule 14a-11, related to proxy access, for inadequate cost-benefit analysis).

[14] Memorandum from the RSFI and OGC to SEC Staff of the Rulewriting Divs. and Offices 1 (Mar. 16, 2012), *available at* http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf (last visited

The SEC and CFTC must now expend significant resources and effort to determine how to promulgate rules with proper cost-benefit analysis, yet without reasonable and clear guidance on which to rely.[15]

Cost-benefit analysis is not a new issue.[16] Since the inclusion of cost-benefit provisions within the SEC and CFTC's organic statutes, the use of such analysis in both agencies' rulemakings has faced mounting criticism.[17] In part, this has been due to the inconsistent application of cost-benefit requirements across government agencies, especially in the financial regulatory context.[18] Much of the criticism, however, has followed the August 2011 U.S. Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") decision in *Business Roundtable v. SEC*.[19] Since *Business Roundtable*, and the subsequent regulatory modifications to the cost-benefit analysis process, the issue has taken on an increased significance.

Aug. 6, 2012) [hereinafter RSFI Memo] (issuing updated guidance on how to conduct future cost-benefit analyses in order to satisfy judicial review).

[15] For example, both the SEC and CFTC have had to publish several guidance documents on how to conduct proper cost-benefit analysis in agency rulemakings. *See, e.g.*, *id*; *see also* OFFICE OF AUDITS, SEC, REPORT NO. 499, FOLLOW-UP REVIEW OF COST-BENEFIT ANALYSES IN SELECTED SEC DODD-FRANK ACT RULEMAKINGS (Jan. 27, 2012) (studying and making six recommendations to improve SEC cost-benefit analysis in rule-makings), *available at* http://www.sec-oig.gov/Reports/AuditsInspections/2012/Rpt%20499_FollowUpReviewofD-F_CostBenefitAnalyses_508.pdf; OFFICE OF THE INSPECTOR GENERAL, COMMODITY FUTURES TRADING COMMISSION, A REVIEW OF COST-BENEFIT ANALYSIS PERFORMED BY THE COMMODITY FUTURES TRADING COMMISSION IN CONNECTION WITH RULEMAKINGS UNDERTAKEN PURSUANT TO THE DODD-FRANK ACT (June 13, 2011), at 30–32, *available at* http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/oig_investigation_061311.pdf (including new guidance issued in 2010 as to how to survive judicial scrutiny).

[16] *See* Edward Sherwin, *The Cost-Benefit Analysis of Financial Regulation: Lessons from the SEC's Stalled Mutual Fund Reform Effort*, 12 STAN. J.L. BUS. & FIN. 1, 1 (2006) ("Over the last twenty-five years, under both Republican and Democratic presidents, no analytical tool has become more fundamental to the modern administrative state than cost-benefit analysis (CBA).").

[17] *Id*. at 2.

[18] *Id*.

[19] 647 F.3d 1144 (2011).

Because the enactment of the Dodd-Frank Act requires both the SEC and CFTC to promulgate hundreds of rules, the cost-benefit analysis debate will likely remain at the forefront of administrative law for some time to come.[20] And with Congress delegating the responsibility of shaping the precise parameters and aspects of financial reform to the SEC and CFTC, this debate will serve an essential, though controversial, role in the promulgation of final rules and regulations.[21]

This Note sets out to provide a comprehensive account and explanation of cost-benefit analysis in SEC and CFTC rulemakings. Part II explores the history and evolution of cost-benefit analysis through Executive Orders and legislation. Part III discusses the SEC's specific cost-benefit analysis requirements of section 3(f) of the Securities Exchange Act of 1934 (the "Exchange Act"). In particular, it examines prior judicial decisions interpreting the SEC's cost-benefit provision, as well as the landmark D.C. Circuit decision in *Business Roundtable*. The discussion of SEC cost-benefit analysis concludes by identifying substantive changes that the SEC has made to its cost-benefit analysis process and agency structure following the *Business Roundtable* decision.

Part IV turns to the CFTC's statutory cost-benefit analysis requirement under section 15(a) of the Commodity Exchange Act ("CEA"). While the history of the CFTC's cost-benefit analysis requirement is not yet as developed as the SEC's, this may begin to change as a result of the CFTC's increased authority under Dodd-Frank to regulate the swaps industry. This section also analyzes a complaint challenging a recent CFTC rulemaking for failing to properly consider the costs and benefits of a final rule. Part IV concludes with a discussion of the CFTC's own internal guidance

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[20] *See* Edward Wyatt, *Dodd-Frank Under Fire A Year Later*, N.Y. TIMES, July 19, 2011, at B1 ("Administration officials say that banking and business lobbyists have spent more than $50 million this year to try to change the law, most of which has still has not taken effect because regulators have not finished drawing up the new rules."); Eugene Scalia, *Why Dodd-Frank Rules Keep Losing in Court*, WALL ST. J., Oct. 4, 2012, at A25.

[21] *See, e.g.*, Ann Saphir, *CME Group Withdraws Complaint Against U.S. Regulator*, Reuters, Nov. 29, 2012, *available at* http://newsandinsight.thomsonreuters.com/Legal/News/2012/11_-_November/CME_Group_withdraws_complaint_against_regulator/ (explaining that CME sued the CFTC for failing to conduct a proper cost-benefit analysis with respect to a rule on warehousing data).

and the difficulties it faces in conducting cost-benefit analysis when promulgating rules that attempt to regulate an industry that has historically never been regulated.

After addressing each agency's statutorily-mandated cost-benefit analysis requirements, the Note turns to the judicial review of cost-benefit analysis in the rulemaking process. Part V provides a thorough assessment of current jurisprudence and its application to cost-benefit analysis as both a procedural and substantive requirement. Part V concludes with an analysis of cases decided by the D.C. Circuit that have found a number of final rules to be arbitrary and capricious for failing to include an adequate cost-benefit analysis. These cases are analyzed to determine whether the D.C. Circuit employed a consistent and proper standard of review with respect to the cost-benefit analysis requirement in SEC rulemakings.

Part VI then provides several options that both the SEC and CFTC, as well as Congress and the judiciary, could pursue to help bring clarity to the often elusory and opaque practice of cost-benefit analysis in SEC and CFTC rulemakings. While these proposals are not meant to be a discrete set of comprehensive solutions, they do seek to direct key players toward potential ways of reforming cost-benefit analysis. This Note ultimately concludes that unless these players take action, cost-benefit analysis will continue to undermine many rules and regulations that attempt to enact the sweeping reforms envisioned by Dodd-Frank.

II. The History of Cost-Benefit Analysis

Cost-benefit analysis requires an agency to determine the public benefits of a proposed rule as compared to the costs associated with its implementation.[22] As the requirements faced by agencies have continued to evolve, so too have the standards imposed by the Executive and Legislative Branches. The next two sub-sections of Part II briefly discuss the relevant developments in cost-benefit analysis through Executive Orders and legislation.

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[22] *See* David Montgomery, *Cost-Benefit Analysis in a Regulatory Setting*, HUMAN AND ECOLOGICAL RISK ASSESSMENT, vol. 4, no. 4, 1998, at 971–89.

A. Executive Orders

Cost-benefit analysis finds its roots in President Richard Nixon's "Quality of Life Review" program.[23] After the Environmental Protection Agency ("EPA") was created in 1970, the White House was immensely concerned with the social and monetary costs imposed on the general public by the Clean Water Act.[24] The Quality of Life Review program was controversial at its inception—and remains so today—though it marks the birth of modern cost-benefit analysis; it represents the first effort to urge agencies to establish their own in-house analytical capacities, to engage in informal consultations with other agencies and industry participants, and to institute internal compliance systems.[25]

While President Nixon's program marked the beginning of cost-benefit analysis in agency rulemakings, subsequent Executive Orders spanning from President Reagan to President Obama have had the greatest impact on the evolving role of cost-benefit analysis in agency rulemaking.[26] On February 17, 1981, for example, President Ronald Reagan issued Executive Order 12,291,[27] which was intended, *inter alia*, to "increase agency accountability for regulatory actions" and "insure well-reasoned regulations."[28] In order

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[23] Sally Katzen, *Why Congress Should Not Codify Cost-Benefit Analysis Requirements*, REGBLOG (June 7, 2011), http://www.law.upenn.edu/blogs/regblog/2011/06/why-congress-should-not-codify-requirements-for-economic-analysis-of-new-regulations.html.

[24] GEORGE C. EADS & MICHAEL FIX, RELIEF OR REFORM: REAGAN'S REGULATORY DILEMMA 46–47 (1984) (detailing how the Nixon Administration responded to concerns about the effects of EPA regulations on the public stemming from the Clean Water Act by creating the Quality of Life Review Process).

[25] *Id*. at 50.

[26] *See* Robert W. Hahn & Cass R. Sunstein, *A New Executive Order for Improving Federal Regulation: Deeper and Wider Cost-Benefit Analysis*, 150 U. PA. L. REV. 1489, 1489–90 (2002) ("For over twenty years, the executive branch of the federal government has required regulatory agencies to assess the costs and benefits of regulation, and to attempt to ensure that the benefits outweigh, or justify, the costs. At least in a formal sense, cost-benefit balancing is now the official creed of the executive branch, as demonstrated by a series of executive orders.").

[27] Exec. Order No. 12,291, 3 C.F.R. 127 (1982), *revoked by* Exec. Order No. 12,866, 3 CFR 638 (1994), *reprinted in* 5 U.S.C § 601 (2006).

[28] *Id.*

to effectuate this purpose, Executive Order 12,291 mandated that a "regulatory action shall not be undertaken unless the potential benefits to society for the regulation *outweigh* the potential costs to society."[29] Additionally, when an agency is choosing among alternative approaches to achieve a regulatory objective, the agency must choose the alternative that involves the "least net cost to society."[30]

Following in Reagan's footsteps, President Bill Clinton issued Executive Order 12,866 on September 30, 1993.[31] In the preamble to his Order, Clinton stated:

> The American people deserve a regulatory system that works for them, not against them: a regulatory system that protects and improves their health, safety, environment, and well-being and improves the performance of the economy without imposing unacceptable or unreasonable costs on society; regulatory policies that recognize that the private sector and private markets are the best engine for economic growth; regulatory approaches that respect the role of State, local, and tribal governments; and regulations that are effective, consistent, sensible, and understandable. *We do not have such a regulatory system today*.[32]

President Clinton adopted several major elements of Executive Order 12,291 in Executive Order 12,866, but also made significant changes to Reagan's requirements.[33] Instead of requiring that benefits outweigh costs, for example, Clinton required an agency

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[29] *Id*. (emphasis added). *See generally* Howard M. Friedman, *The Oversupply of Regulatory Reform: From Law to Politics in Administrative Rulemaking*, 71 NEB. L. REV. 1169, 1179–81 (1992).
[30] See Executive Order 12,291, *supra* note 27.
[31] Exec. Order No. 12,866, 3 CFR 638 (1994), *reprinted in* 5 U.S.C § 601 (2006) (revoking Reagan's Executive Order 12,291).
[32] *Id*. (empasis added).
[33] *Id.*; *see also* Steven Croley, *White House Review of Agency Rulemaking: An Empirical Investigation*, 70 U. CHI. L. REV. 821, 827 (2003) (explaining that Clinton's Executive Order "embodied both the substantive and procedural aspects of the Reagan orders – imposing cost-benefit criteria for major rules and designating OMB as the central overseer and clearinghouse for agency rulemaking.").

to "design its regulations in the most cost-effective manner to achieve the regulatory objective" and only to propose or adopt a regulation "upon a reasoned determination that the benefits of the intended regulation *justify* its costs."[34] President Clinton realized that a proper regulatory approach required flexibility and adaptability, not the rigidity that is evident in the language adopted by Reagan.[35]

In 2007, President George W. Bush issued Executive Order 13,422, which broadened Executive Order 12,866 by extending the review process to major guidance documents.[36] Prior to Executive Order 13,422, cost-benefit analysis only applied to legislative rulemakings. Major guidance documents included policy statements and interpretive statements.[37] However, President Barack Obama subsequently revoked the extension of review to guidance documents.[38] Furthermore, on January 18, 2011, Obama issued Executive Order 13,563 to reaffirm the "principles, structures, and definitions governing contemporary regulatory review that were established in [Clinton's] Executive Order 12,866."[39] President

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[34] See Executive Order 12,866 *supra* note 31, at 639 (emphasis added).

[35] *See generally* Daniel A. Farber, *Rethinking the Role of Cost-Benefit Analysis*, 76 U. CHI. L. REV. 1355, 1355 (2009) (reviewing RICHARD L. REVESZ & MICHAEL A. LIVERMORE, RETAKING RATIONALITY: HOW COST-BENEFIT ANALYSIS CAN BETTER PROTECT THE ENVIRONMENT AND OUR HEALTH (2008)); Richard H. Pildes & Cass R. Sunstein, *Reinventing the Regulatory State*, *Reinventing the Regulatory State*, 62 U. CHI. L. REV. 1, 43–46 (1995).

[36] Exec. Order No. 13,422, 3 C.F.R. 191 (2008), *revoked by* Exec. Order No. 13497, 3 C.F.R. 218 (2010), *reprinted in* 5 U.S.C. § 601 (Supp. V. 2012) (allowing the Office of Management and Budget ("OMB") to review not only legislative rules, which carry the force of law, but major statements meant to guide third-parties).

[37] *Id.*; *see also* Administrative Procedure Act, ch. 324, 60 Stat. 237 (1946) (codified as amended at 5 U.S.C. §§ 551–559, 701–706 and additional scattered sections of 5 U.S.C.).

[38] Exec. Order No. 13,497, 3 C.F.R. 218 (2010), *reprinted in* 5 U.S.C. § 601 (Supp. V. 2012) (directing Director of OMB and heads of executive departments and agencies to rescind any "orders, rules, regulations, guidelines, or policies implementing or enforcing . . . Executive Order 13422, to the extent consistent with law").

[39] Exec. Order No. 13,563, 3 C.F.R. 215 (2012), *reprinted in* 5 U.S.C. § 601 (Supp. V. 2012); *see also* Cass R. Sunstein, *Empirically Informed Regulation*, 78 U. CHI. L. REV. 1349, 1387–88 ("Stressing the importance of attempting to measure and improve 'the actual results of regulatory requirements,' it specifically adds that 'each agency is directed to use the

Obama reiterated the importance of flexibility between quantitative and qualitative measures by stating

> In applying these principles, each agency is directed to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible. Where appropriate and permitted by law, each agency may consider (and discuss qualitatively) values that are difficult or impossible to quantify, including equity, human dignity, fairness, and distributive impacts.[40]

On July 11, 2011, in an effort to streamline and improve regulations, President Obama issued Executive Order 13,579, an historic initiative requesting that independent regulatory agencies adopt "new steps to ensure smart, cost-effective regulations, designed to promote economic growth and job creation."[41] Yet even President Obama acknowledges the limitation of Executive Orders. While he encourages independent agencies "to give consideration to all of [the Order's] provisions" and "consider undertaking, on a voluntary basis, retrospective analysis of existing rules, it remains the case that Executive Orders are [only] helpful in understanding the goals of cost-benefit analysis, but are not, as a matter of law, binding authority on independent agency analysis"[42]

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best available techniques to quantify anticipated present and future benefits as accurately as possible-and that 'each agency may consider (and discuss qualitatively) values that are difficult or impossible to quantify, including equity, human dignity, fairness, and distributive impacts.'").

[40] Exec. Order No. 13,563, *supra* note 39.

[41] Cass Sunstein, *The President's Executive Order on Improving and Streamlining Regulation by Independent Regulatory Agencies*, THE WHITE HOUSE BLOG (July 11, 2011, 6:28 PM), http://www.whitehouse.gov/blog/2011/07/11/president-s-executive-order-improving-and-streamlining-regulation-independent-regula.

[42] Memorandum from Cass R. Sunstein to the Heads of Executive Departments and Agencies, and of Independent Regulatory Agencies M-11-10 (Feb. 2, 2011), *available at* http://www.whitehouse.gov/sites/default/files/omb/memoranda/2011/m11-10.pdf ("Executive Order 13563 does not apply to independent agencies, but such agencies are encouraged to give consideration to all of its provisions, consistent with their legal authority. In particular, such agencies are encouraged to consider undertaking, on a voluntary basis, retrospective analysis of existing rules")

Because this Note focuses on cost-benefit analysis as implemented by the SEC and CFTC, which are both independent agencies, Executive Orders will provide only persuasive commentary. Indeed, Executive Orders typically contain a provision stating that the order does not create any right or benefit enforceable at law, thus expressly precluding review.[43] Nevertheless, Executive Orders are important to understanding the complete history of cost-benefit analysis and its evolution in the regulatory process. It is unclear to what extent the judiciary relies on the guidance provided in these Executive Orders to determine whether the cost-benefit analysis employed by independent agencies is sufficient to withstand judicial review. Although President Obama has received immediate, favorable feedback from some independent agencies, including the Federal Trade Commission, the SEC and CFTC have not commented on the directive.[44]

B. Congressional Actions

In addition to Executive Orders, Congress has also sought to impose cost-benefit requirements on agencies when promulgating rules and regulations. Other than the inclusion of specific language within an agency's organic statute (discussed in Parts III & IV, below), Congress has primarily established cost-benefit requirements through four separate pieces of legislation: (1) the Administrative Procedure Act ("APA");[45] (2) the Regulatory Flexibility Act ("RFA");[46] (3) the Paperwork Reduction Act ("PRA");[47] and, (4) the

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[43] *See, e.g.*, Exec. Order 13,497, *supra* note 38, at 6113 ("This order is not intended to, and does not, create any right or benefit, substantive or procedural, enforceable at law or in equity by any party against the United States, its departments, agencies, or entities, its officers, employees, or agents, or any other person."); *see also* Peter Raven-Hansen, *Making Agencies Follow Orders: Judicial Review of Agency Violations of Executive Order 12,291*, 1983 DUKE L.J. 285, 330–31 (1983).

[44] *See* Sunstein, *supra* note 41.

[45] Administrative Procedure Act (APA), ch. 324, 60 Stat. 237 (1946) (codified as amended at 5 U.S.C. §§ 551–559, 701–706 and additional scattered sections of 5 U.S.C.) (2006 & Supp. V. 2011).

[46] Regulatory Flexibility Act (RFA), Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified as amended at 5 U.S.C. §§ 601–612) (2006 & Supp. V 2011).

Unfunded Mandates Reform Act ("UMRA").[48] Because Congress creates independent agencies by statute, which function largely outside the control of the Executive branch, congressional action or inaction is extremely important.[49]

1. Administrative Procedure Act

In 1946, Congress unanimously enacted the APA in an effort to attain greater uniformity of the different procedures used by federal agencies.[50] The main goals of the APA were (1) to require agencies to keep the public informed and up-to-date on current procedures and rules; (2) to stimulate public comment in the rulemaking process; (3) to dictate uniform standards for formal rulemaking and adjudication; and (4) to outline judicial review of federal agencies.[51] As for judicial review, the APA requires that, in order for courts to set aside an agency action, they must find the informal rulemaking "arbitrary and capricious, an abuse of discretion, or otherwise not in accordance with the law."[52] Therefore, although the APA lends itself to diverse interpretations, it does not

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[47] Paperwork Reduction Act (PRA) of 1980, Publ. L. No. 96-511, 94 Stat. 2812 (codified as amended at 44 U.S.C. § 3501–3520) (2006 & Supp. V 2011).

[48] Unfunded Mandates Reform Act of 1995 (UMRA), Pub. L. No. 104-4, 109 Stat. 48 (codified as amended at 2 U.S.C. §§ 658, 658a-658g, 1501–1504, 1511–1516, 1531–1538, 1551–1556, 1571 (2006).

[49] *See generally* Richard H. Pildes, *Separation of Powers, Independent Agencies, and Financial Regulation: The Case of the Sarbanes-Oxley Act*, 5 N.Y.U. J.L. & BUS. 485 (2009).

[50] S. REP. NO. 758, at 193 (1945) (explaining that the Senate considered the APA an "outline of minimum basic essentials"); APA 5 U.S.C. §§ 551– 559 (containing first statutorily imposed procedures, such as guidelines for adjudication, rulemaking and governance of judicial review, that apply to all agencies, executive and independent).

[51] DEP'T OF JUSTICE, ATTORNEY GENERAL'S MANUAL ON THE ADMINISTRATIVE PROCEDURE ACT 9 (1947), *available at* http://www.law.fsu.edu/library/admin/1947i.html.

[52] APA, 5 U.S.C. § 706(2)(A); Fred Anderson, *et al.*, *Regulatory Improvement Legislation: Risk Assessment, Cost-Benefit Analysis, and Judicial Review*, 11 DUKE ENVTL. L. & POL'Y F. 89, 111–12 (2000) (explaining that although all three standards are available to the judiciary, the arbitrary and capricious standard plays the most significant role). The arbitrary and capricious standard will be explained more fully in Section V.

place a procedural requirement on agencies to engage in cost-benefit analysis in agency rulemakings.[53]

2. Regulatory Flexibility Act

Congress enacted the Regulatory Flexibility Act ("RFA") on September 19, 1980 "to improve federal rulemaking by creating procedures to analyze the availability of more flexible regulatory approaches for small entities."[54] In particular, the RFA requires agencies to "prepare and make available for public comment an initial regulatory flexibility analysis" when publishing a notice of proposed rulemaking.[55] This initial regulatory flexibility analysis requires each agency to identify why it is acting, its objectives, an estimate of the number of small entities likely to be affected, and any federal rules that may "duplicate, overlap or conflict with the proposed rule."[56] Additionally, in the adopting release, the agency must provide a succinct statement of the proposed rule as well as a summary of the issues raised during public comment regarding the initial regulatory flexibility analysis.[57] The agency must also identify any changes that were made in response to these comments and a description of each significant alternative to the rule chosen explaining the economic impact of each on small entities and why the agency rejected them.[58] Beyond these more general requirements, the RFA allows for both quantitative and qualitative descriptions of the effects of the proposed rule and its alternatives.[59] Finally, the RFA imposes a requirement on agencies to periodically review rules that have or will have a "significant economic impact upon a substantial number of small entities."[60]

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[53] APA, 5 U.S.C. § 551 *et seq. See also* Jennifer Nou, *Regulating the Rulemakers: A Proposal for Deliberative Cost-Benefit Analysis*, 26 YALE L. & POL'Y REV. 601, 607 (2008) (explaining that attempts to formally codify cost-benefit requirements in the APA have failed, and only "strong norms" derived from "a mix of executive orders, guidance documents, and best-practice manuals" exist).

[54] RFA, 5 U.S.C. §§ 601–612 (2006 & Supp. V 2012).

[55] *Id.* § 603(a).

[56] *Id*.

[57] *See id.* § 604.

[58] *Id.*

[59] *See id*. § 607.

[60] *See id.* § 610(a).

3. Paperwork Reduction Act

Enacted only a few months after the RFA,[61] the Paperwork Reduction Act ("PRA") created the Office of Information and Regulatory Affairs ("OIRA") within the Office of Management and Budget ("OMB"), and authorized it to develop and implement policies regarding federal information and to establish information resource management policies.[62] The PRA also requires each agency to "improve [its] productivity, efficiency, and effectiveness,"[63] and to disseminate public information in "an efficient, effective, and economical manner."[64] The overall goal of the PRA was to decrease the amount of paperwork flowing into and between government agencies.[65] In particular, the PRA requires agencies in their proposed and final rulemakings to identify whether a new rule or regulation will lead to an increase in the collection of information.[66] While the PRA focuses more on the costs in terms of paperwork production, it remains a way for Congress to ensure agencies are considering negative externalities of new regulations.

4. Unfunded Mandates Reform Act

The final piece of legislation that plays a role in agency cost-benefit analysis is the Unfunded Mandates Reform Act ("UMRA"). Passed on March 22, 1995, the UMRA ensures that the federal government estimates the costs imposed by regulations on local and state governments.[67] In this respect, the UMRA is similar to the RFA, in that it requires agencies, "before promulgating any rule," to "identify and consider a reasonable number of regulatory alternatives and from these alternatives select the least costly, most-effective or

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[61] Paperwork Reduction Act of 1980, 44 U.S.C. §§ 3503 (2006).
[62] U.S. OFFICE OF MGMT. & BUDGET, CIRCULAR NO. A-130 REVISED, TRANSMITTAL MEMORANDUM NO. 4, MANAGEMENT OF FEDERAL INFORMATION RESOURCES (2000), *available at* http://www.whitehouse.gov/sites/default/files/omb/assets/omb/circulars/a130/a130trans4.pdf.
[63] PRA, 44 U.S.C. § 3506(a)(1)(A).
[64] *Id.* § 3506(d)(1).
[65] *See* Felicity Barringer, *108 Million Hours Said Saved in '83; Paperwork-Reduction Effort Exceeds Goal*, WASH. POST, Jan. 14, 1983, at A13.
[66] 44 U.S.C. § 3506(c)(2)(B).
[67] *See* Unfunded Mandates Reform Act of 1995, 2 U.S.C. § 1501 (7)(B) (2006).

least burdensome alternative . . . that achieves the objectives of the rule, for . . . state, local, and tribal governments."[68]

While these four acts impose specific requirements on federal agencies, those requirements are relatively straightforward and simple to meet.[69] However, agencies like the SEC and CFTC have specific provisions that go further than the aforementioned requirements.[70] Currently, there are no authoritative guidelines or rules that exist for how an independent agency is to conduct cost-benefit analysis when promulgating a rule or regulation.[71] While Executive Orders provide a framework that independent agencies are encouraged to follow, they do not ultimately bind independent agencies.[72] For this reason, independent agencies are at a loss when determining the extent to which such analysis should be conducted and the resources they must expend to obtain or create quantifiable measures.[73]

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[68] 2 U.S.C. § 1535(a). *See generally* Daniel H. Cole & Carol S. Corner, *Rhetoric, Reality, and the Law of Unfunded Federal Mandates*, 8 STAN. L. & POL'Y REV. 103 (1997).

[69] *See generally* Note, *Congress Requires a Separate, Recorded Vote for Any Provision Establishing an Unfunded Mandate*, 109 HARV. L. REV. 1469 (1996).

[70] *See* Securities Exchange Act of 1934, ch. 404, 48 Stat. 881, 15 U.S.C § 78c(f) (2006) (requiring the SEC to consider whether an action will "promote efficiency, competition, and capital formation"); Commodity Exchange Act, ch. 369, 42 Stat. 998, 7 U.S.C. § 19(a) (2006) (imposing requirements to tailor CBA for financial markets).

[71] This is true because only federal statutes or guidance issued by Congress bind independent regulatory agencies. However, as mentioned previously, independent regulatory agencies are encouraged to abide by Executive Orders and guidance issued by the OMB and OIRA. *See also* Curtis W. Copeland, *The Role of the Office of Information and Regulatory Affairs in Federal Rulemaking*, 33 FORDHAM URB. L.J. 1257, 1261, 71–72 (2006) (acknowledging that Executive Orders suggest cost-benefit analysis, but generally bind only covered agencies, not independent regulatory agencies).

[72] Curtis W. Copeland, CONG. RESEARCH SERV., R41974, Cost-Benefit and Other Analysis Requirements in the Rulemaking Process 16 (2011), *available at* http://www.law.yale.edu/documents/pdf/cbl/CRSReportonCBAAugust2011.pdf; *see also* Scott Patterson, *Bill Aims at Rules' Costs, Benefits*, WALL ST. J., Sept. 7, 2012 (identifying a recent push in Congress to enact the Independent Agency Regulatory Analysis Act of 2012, which would streamline the cost-benefit process by requiring an independent analysis of all agencies).

[73] *See* Nou, *supra* note 53, at 607.

III. Securities and Exchange Commission's Cost-Benefit Analysis

A. Statutory Basis and Legislative History

The National Securities Markets Improvement Act of 1996 ("NSMIA") added section 3(f) to the Securities Exchange Act of 1934 ("Exchange Act").[74] Section 3(f) requires that, whenever the SEC is engaged in a rulemaking, or reviewing the rule of a self-regulatory organization ("SRO"), it is required to determine whether "an action is necessary or appropriate in the public interest" and whether it "will promote *efficiency, competition and capital formation*."[75]

Senate Report No. 104-293 explained that NSMIA reforms would "enhance investor protection while reducing the costs of investing."[76] To achieve this effect, NSMIA increased the role of economic analysis in the SEC's regulatory procedures.[77] First, NSMIA doubled the SEC's appropriations to $6 million annually for its Economic Analysis Program.[78] Second, NSMIA required the SEC's Chief Economist to prepare an economic analysis report for each proposed regulation to be made available not only internally, but also to the public.[79] Importantly, the Senate sought "serious economic analysis throughout the process of developing regulations."[80] The public analysis report on a proposed regulation must include an analysis of the costs imposed on the U.S. economy, and an estimated impact on market action, "including any impact on market liquidity, the costs of investment, and the financial risks of investment."[81] Therefore, section 3(f) may be read to require the SEC to conduct a cost-benefit analysis when promulgating a rule.

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[74] 15 U.S.C. § 78c(f) (2006).
[75] *Id.* (emphasis added).
[76] S. REP. No. 104-293, at 2 (1996) (describing the goals of the Securities Investment Protection Act, which was one of the bills enrolled into the NSMIA).
[77] *Id.* at 16.
[78] *Id.* (detailing how $6 million was double the amount appropriated to the Economic Analysis Program during the previous fiscal year, and totaling roughly $3 million).
[79] *Id.* (calling for the publication of each promulgation in the Federal Register).
[80] *Id.*
[81] *Id.* at 28–29.

B. Prior D.C. Circuit Decisions

Although the legislative history provides some context behind the development of a cost-benefit requirement in rulemakings, the D.C. Circuit has played a significant role in shaping the design of these analyses. The following two cases from the D.C. Circuit provided the foundation for the SEC's cost-benefit analysis requirement when promulgating rules.

1. Chamber of Commerce v. SEC

In *Chamber of Commerce v. SEC*,[82] the court held that the SEC violated the APA by failing to consider the costs that mutual funds would incur by complying with the conditions announced in a new rule, and by failing to consider a proposed alternative to the new condition articulated in the final rule.[83] The final rule that the petitioners challenged raised the percentage requirement for independent directorship from 50% of mutual fund directors to 75%.[84] The court took issue with a particular SEC statement in the adopting release of the final rule: "As noted in the Proposing Release, our staff has no reliable basis for determining how funds would choose to satisfy this requirement and therefore it is difficult to determine the costs associated with electing independent directors."[85] The court explained that "uncertainty may limit what the Commission can do, but it does not excuse the Commission from its statutory obligation to do what it can to apprise itself."[86] In other words, simply stating that there is "no reliable basis" for determining "cost" is insufficient and does not excuse the SEC from engaging in real cost-benefit analysis. The court concluded that, although the SEC could not estimate the aggregate cost of the rule to the mutual

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[82] 412 F.3d 133 (D.C. Cir. 2005).
[83] *Id.* at 136.
[84] *Id.* at 137.
[85] Investment Company Governance, 69 Fed. Reg. 46,378, 46,387 (Aug. 2, 2004).
[86] *Chamber of Commerce*, 412 F.3d at 144; *see also* Anthony W. Mongone, Note, *Business Roundtable: A New Level of Judicial Scrutiny and Its Implications in a Post-Dodd-Frank World*, 2012 COLUM. BUS. L. REV. 746, 756 (2012) (highlighting the court's recognition in *Chamber of Commerce* that uncertainty may limit an agency's ability to conduct empirical analysis, yet does not absolve the agency of its APA obligation to make reasoned decisions).

fund industry, it could have still estimated the cost to an individual fund, which "would be pertinent to [an] assessment of the effect the condition would have upon *efficiency and competition*, if not upon *capital formation*."[87]

Chamber of Commerce provides that hesitancy and uncertainty regarding the accuracy or reliability of an estimate do not preclude the SEC from determining "as best it can" the economic implications of a proposed rule.[88] Furthermore, the SEC, when determining the economic implications of a new rule, must assess and analyze the costs that the new rule might impose.[89]

2. American Equity Investment Life Insurance Co. v. SEC

American Equity Investment Life Insurance Co. v. SEC[90] involved a challenge to SEC Rule 151A, a new rule which determined that fixed indexed annuities ("FIAs") were not annuity contracts within the meaning of the Securities Act of 1933 ("Securities Act").[91] Petitioners brought suit arguing that the SEC "unreasonably interpreted the term 'annuity contract' not to include FIAs," and alternatively, failed to properly consider the effect of the rule upon efficiency, competition, and capital formation.[92] The court held that the SEC's interpretation of annuity contract was "reasonable under *Chevron*," but granted the petition on the alternative argument.[93]

The SEC argued that, under the Securities Act, it was not required to conduct a § 2(b) analysis[94] when it promulgated this rule.[95] The court rejected this argument, however, because the SEC had conducted its analysis when it issued the rule with no assertion

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[87] *Chamber of Commerce*, 412 F.3d at 144 (emphasis added).
[88] *Id.* at 143; *cf.* Mongone, *supra* note 85, at 756 ("[T]he court nonetheless held that the SEC's decision not to perform its own empirical study does not *necessarily* render the agency's conclusions unreasoned.").
[89] *Chamber of Commerce*, 412 F.3d at 144.
[90] 613 F.3d 166 (D.C. Cir. 2010).
[91] *Id.* at 167.
[92] *Id*.
[93] *Id*. at 167–68.
[94] Section 2(b) of the Securities Act requires the SEC to consider the rule's effect on efficiency, competition, and capital formation. Section 2(b) of the Securities Act is functionally equivalent to Exchange Act section 3(f).
[95] *American Equity*, 613 F.3d at 177.

that it was *not* required to do so.[96] The court explained that the SEC must defend its analysis on the basis it employed in adopting the analysis.[97] The court ruled that simply because the SEC was creating a rule to provide greater clarity to an area that was previously unclear in the absence of any rule does not automatically mean that the rule would increase competition.[98] Indeed, the court found that "[t]he SEC could not accurately assess any potential increase or decrease in competition . . . because it did not assess the baseline level of price transparency and information disclosure under state law."[99] The SEC's analysis was thus arbitrary and capricious because it failed to consider the extent of existing competition, if any, in its analysis.[100] *American Equity* requires the SEC, when engaging in cost-benefit analysis, to identify and assess the current regulatory climate prior to the implementation of a new rule. In doing so, the SEC will create a baseline in which it can compare and contrast the potential economic implications of the rule when determining the rule's impact on efficiency, competition, and capital formation.[101]

C. Proxy Access & Exchange Rule 14a-11

In the summer of 2011, the D.C. Circuit in *Business Roundtable v. SEC*[102] reviewed a challenge to a SEC rulemaking that alleged the Commission had not properly considered the action's effect of on efficiency, competition, and capital formation.[103] The three-judge panel unanimously ruled against the SEC and vacated the rule while also harshly rebuking the SEC for not adequately analyzing the costs to companies of fighting in contested board elections.[104] Many commentators consider the decision to have broad

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[96] *Id.*
[97] *Id*. ("The grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based." (quoting SEC v. Chenery Corp., 318 U.S. 80, 87 (1943))).
[98] *Id.* at 177–78.
[99] *Id.* at 178.
[100] *Id.*
[101] *See id.* at 178–79.
[102] 647 F.3d 1144 (D.C. Cir. 2011).
[103] *Id.* at 1146.
[104] Jessica Holzer, *Court Deals Blow to SEC, Activists*, WALL ST. J., July 23, 2011, at B3.

implications, as it followed a string of losses for the SEC.[105] Moreover, the D.C. Circuit went further than it had in those previous cases by identifying several problems with the SEC's assessment of the final rule's economic impact.[106]

The following sections provide an in-depth summary of the history of the SEC's proxy access rule, the proposed and final rules, and the SEC's cost-benefit analysis in both. Following these summaries, the D.C. Circuit's reasoning in striking down the rule will be explained.

1. History of Proxy Access Regulation

For decades, Congress and the SEC have expressed concern over the rules governing shareholder access to management proxy materials.[107] As a result, judicial review of the SEC's shareholder access rules to management's annual proxy materials faced difficult scrutiny.[108] In 1934, Congress authorized the SEC to oversee the development of rules regulating shareholder access to management proxy materials.[109] Later in 1942, and again in 1977, the SEC considered regulating access to company proxy materials, but took no immediate action.[110]

In 1996, through the enactment of NSMIA, Congress directed the SEC to undertake a comprehensive yearlong review of shareholder nominations to the board of directors using the annual

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[105] *Id.*; *see* Chamber of Commerce v. SEC, 412 F.3d 133, 136 (D.C. Cir. 2005); *American Equity*, 613 F.3d at 166; *see also* discussion *supra* Part III.b.

[106] *See* Noam Noked, *Implications of the Proxy Access Case*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Aug. 23, 2011, 9:15 AM), http://blogs.law.harvard.edu/corpgov/tag/business-roundtable-v-sec/.

[107] *See generally* Lawrence E. Mitchell & Dalia T. Mitchell, *The Financial Detriments of American Corporate Governance: A Brief History*, *in* CORPORATE GOVERNANCE: A SYNTHESIS OF THEORY, RESEARCH, AND PRACTICE 19, 19–33 (H. Kent Baker & Ronald Anderson eds., 2010).

[108] *Id.*

[109] Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29,024, 29,025 (proposed June 18, 2009); *see also* Grant M. Hayden, *The Bizarre Law and Economics of* Business Roundtable v. SEC, 38 IOWA J. CORP. L. 101, 103 (2012).

[110] Marcel Kahan & Edward B. Rock, *The Insignificance of Proxy Access*, 97 VA. L. REV. 1347, 1353 (2011); *see also* Jill E. Fisch, *The Destructive Ambiguity of Federal Proxy Access*, 61 EMORY L.J. 435, 441 (2012).

meeting management proxy materials.[111] Specifically, Congress required the SEC to report back about the current status of shareholder access to proxy statements and the impact of recent statutory, judicial, or regulatory actions on shareholders' ability to include proposals relating to corporate practices and social issues.[112] The SEC, perhaps motivated by the NSMIA requirements, issued a proposed rule in 2003.[113] Despite approval of the proposal by a 3-2 vote of the Commissioners,[114] the SEC failed to adopt a final rule because of external pressure from both the Business Roundtable[115] and the U.S. Chamber of Commerce.[116] Furthermore, the proposal lacked critical support from newly-appointed Chairman William H. Donaldson, who was not an advocate of shareholder proxy access.[117]

The most recent push for reform to proxy access came in 2010 with the enactment of the Dodd-Frank Act.[118] The Dodd-Frank Act allowed the SEC to promulgate rules "permitting the use by a shareholder of proxy solicitation materials supplied by an issuer of securities" in order to nominate directors to the board.[119] Consequently, the SEC promulgated rules, including Rule 14a-11,

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[111] S. REP. No. 104-293, at 19 (1993) (requiring Commission to complete study and return results to Congress within a calendar year).

[112] *Id.* at 32.

[113] *Id.* at 19; Kahan, *supra* note 107, at 1353.

[114] Kahan, *supra* note 107, at 1353.

[115] Business Roundtable, according to its website, is "an association of chief executive officers of leading U.S. companies with over $6 trillion in annual revenues and more than 14 million employees. BRT member companies comprise nearly a third of the total value of the U.S. stock market and invest more than $150 billion annually in research and development – nearly half of all private U.S. R&D spending. [These] companies pay $163 billion in dividends to shareholders and generate an estimated $420 billion in sales for small and medium-sized businesses annually. BRT companies give nearly $9 billion a year in combined charitable contributions." BUSINESS ROUNDTABLE, http://businessroundtable.org/about-us/ (last visited Sept. 11, 2012).

[116] Kahan, *supra* note 107, at 1351–52.

[117] While Chairman Donaldson initially supported the 2003 proposal, he did not follow through with pushing forward its adoption. His successor, Chairman Christopher Cox, was not regarded as a "champion of proxy access." Consequently, proxy access was considered dead. *Id.* at 1353–54.

[118] Dodd-Frank Act, Pub. L. No. 111–203, § 971, 124 Stat. 1376, 1915 (2010) (amending the Securities Exchange Act of 1934 to require the SEC to issue rules on proxy access).

[119] *Id.*

regulating shareholder access to the management proxy materials for the purpose of nominating directors.[120]

2. Proposed Exchange Rule 14a-11

One year prior to the enactment of the Dodd-Frank Act, the SEC released a proposed rule entitled *Facilitating Shareholder Director Nominations* ("Proposed Rule"). The Proposed Rule revisited and attempted to resolve the contentious issue of shareholder proxy access.[121] The purpose of the Proposed Rule was to address whether boards were "exercising appropriate oversight management . . . appropriately focused on shareholder interests, and whether [they] need to be more accountable for their decisions regarding such issues as compensation structures and risk management."[122] Specifically, the Proposed Rule sought to require companies to include shareholder nominations for directors in the their proxy materials, as the SEC determined that current, federal proxy rules inhibited shareholders from effectively exercising their rights in the nomination and election of company directors.[123] The

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[120] Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668, 56,771 (Sept. 16, 2010) (to be codified at 17 C.F.R. pt. 240).

[121] *See* Fisch, *supra* note 107, at 447; *see also* Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29,024, 29,025 (proposed June 18, 2009) (to be codified at 17 C.F.R. pt. 240) (detailing that in light of the above concerns, as well as the 2008 economic crisis enveloping the country, the SEC viewed the summer of 2009 as the appropriate time to re-address proxy access).

[122] Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,025.

[123] *Id.* at 29,031*; see generally* Hayden, *supra* note 106, at 106 (detailing the added requirements the Proposed Rule imposed on companies). If adopted, the Proposed Rule would have several barriers to use by shareholders. The first barrier to entry was that, to use the Proposed Rule, shareholders would have to met certain eligibility requirements. The first requirement is that only holders of a "significant, long-term interest in a company" would be eligible to have their disclosures about their nominee included within the company's proxy materials. A "significant, long-term interest" is determined using a minimum ownership threshold that starts at as little as 1 to 5%. The second eligibility requirement is that the shareholder "beneficially own" this threshold percentage for at least one year prior to the date of the shareholder notice, and must represent intent to continue to own those securities through the date of the annual or special meeting. The second barrier to entry was that shareholders would only be able to use the Proposed Rule so long as they were not seeking to change control of the

reach of the Proposed Rule, however, would be limited if the law of the state in which the company is incorporated, or the company's governing documents, explicitly prohibited shareholders from nominating directors.[124]

A primary catalyst behind the Proposed Rule was that, by removing the impediments that prevented shareholders from fully exercising their rights to participate in the nomination and election of company directors, the costs to shareholders should subsequently decrease.[125] Furthermore, the SEC anticipated that the Proposed Rule would lead to four distinct benefits and three distinct costs. The first of these benefits was a reduction in the cost to shareholders of soliciting votes in support of a nominated candidate for election to the board of directors.[126] By allowing shareholders to avoid the direct costs of director nominations, the SEC estimated that the Proposed Rule would save shareholders at least $18,000.[127] Alternatively, from the perspective of the company, the SEC predicted that the Proposed Rule could help companies avoid potential disruptions and the diversion of resources that often result from traditional proxy contests.[128]

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issuer or attempting to gain more than a limited number of seats on the board of directors. Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,035–38.

[124] Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,031.

[125] *Id*. at 29,071 (believing that the reduced cost to shareholders would create two distinct economic effects: (1) shareholders would move away from soliciting their own proxies for nominees and instead require the company to include their nominees in the company's proxy materials, and (2) lowering the cost of nominating directors would yield an increase in shareholder nominees for director); *cf.* Fisch, *supra* note 107, at 453 ("As the SEC explained, the federal proxy rules were designed to replicate, as nearly as possible, an in-person shareholder meeting. At an in-person meeting, shareholders have the power to nominate as well as elect director candidates.").

[126] Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,073.

[127] *Id.* The SEC relied on studies of proxy contests that were conducted from 2003 to 2005 to estimate that the average cost of a traditional proxy contest was $368,000. Of this $368,000, it was estimated that approximately $18,000 was attributable to printing and postage costs. Furthermore, the SEC believed that the Proposed Rule would mitigate collective action and free rider concerns that may have otherwise deterred shareholders. *Id.*

[128] *Id*.

The second benefit was an improved disclosure of shareholder-nominated director candidates, which would require shareholders to provide additional information.[129] The SEC believed that requiring additional information would provide transparency to shareholders voting on shareholder nominees and may consequently lead to more symmetrical voting decisions.[130]

The third benefit was that the Proposed Rule might result in increased company performance through improved board performance.[131] The SEC identified three ways in which the Proposed Rule could increase board performance: first, the election of a shareholder nominee might increase the scrutiny an incumbent may face;[132] second, the increased shareholder voice in board elections might lead to a board whose interests were better aligned with those of its shareholders;[133] and third, the inclusion of shareholder nominees within a company's proxy materials might yield a larger pool of qualified director nominees from which to choose from.[134]

The fourth benefit was an enhanced ability for shareholders and companies to adopt procedures.[135] The SEC proposed that adoption of Rule 14a-11, along with the amendment to Rule 14a-8, which also resulted from the Proposed Rule, should facilitate shareholders and companies to work together to compose the

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[129] *Id.*; *cf.* Fisch, *supra* note 107, at 448 ("Under the rule, a nominating shareholder or group had to file a Schedule 14N between 120 and 150 days prior to the first anniversary of the mailing of the proxy statement for the issuer's prior annual meeting.").

[130] Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,073. Furthermore, this additional information would also provide consistent and comparable information about shareholder nominees across companies. *Id.*

[131] *Id*. *See generally*, Fisch, *supra* note 107, at 454 ("[T]he SEC . . . concluded that its rule changes would 'significantly enhance the confidence of shareholders who link the recent financial crisis to a lack of responsiveness of some boards to shareholder interests.'").

[132] Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,073. The potential benefit is asserted on the basis that the closer scrutiny may cause incumbent directors to work more diligently in order to demonstrate their value to the company. *Id*.

[133] *Id*. at 29,074. By enhancing accountability to the shareholders, the board would feel a need to be more attentive to the company's operations. *Id.*

[134] *Id*.

[135] *Id*.; *see* Fisch, *supra* note 107, at 497.

company's governing documents in a way that best suits both sides' interests.[136]

In addition to the four benefits listed above, the SEC explained that costs might result from three distinct potential consequences of the Proposed Rule.[137] The first cost stemmed from the Proposed Rule's potential adverse effect on company and board performance.[138] Every company subject to the Proposed Rule would have to re-examine its current procedures for director elections and might incur direct economic costs to come into compliance.[139] Additionally, as the Proposed Rule focused on the importance of shareholders' interests and rights in a director election, the SEC predicted that companies might feel a greater need to respond to shareholder concerns than they did before.[140] Furthermore, the SEC proposed that an increased likelihood of the election of a shareholder nominee may lead to less qualified boards.[141] As the cost of introducing a new director who is a shareholder nominee could possibly impair or disrupt the dynamic of the boardroom,[142]

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[136] Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,074. The SEC ultimately concluded that any benefits that may derive from promulgation of Rule 14a-11 will ultimately depend on the shareholders use of it. *Id.*

[137] *Id.* ("We anticipate that the amendments, where applicable, may result in costs related to (1) potential adverse effects on company and board performance; (2) potential complexity of the proxy process; and (3) preparing the required disclosures, printing and mailing, and costs of additional solicitations.").

[138] *Id.*

[139] *Id.*

[140] *Id*. The increased need to respond will likely result in the company spending more time and resources on shareholder relations that would have otherwise been allocated for "strategic and long-term thinking and overseeing management." *Id.*

[141] *Id*. at 29,075; *see* Fisch, *supra* note 107, at 497 ("Another approach could authorize corporations to increase board size to accommodate shareholder-nominated candidates without displacing existing issuer nominees. This approach would increase shareholder input without creating an active contest that might displace sitting directors.").

[142] It was speculated that impairing the dynamic may cause delays in decision making. Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,075.

companies may be incentivized to increase spending and resources to oppose and defeat shareholder nominees.[143]

The second cost stemmed from the potentially complex proxy process. The Proposed Rule placed certain limitations on the number of shareholder nominees that could be nominated or could serve on the board at any one time.[144] However, vast company resources could be spent seeking legal advice on ensuring compliance with the Proposed Rule as well as reviewing shareholder eligibility requirements.[145]

The third cost was related to preparing disclosures, printing and mailing, and the costs of additional solicitations.[146] The SEC estimated the direct economic costs, on both reporting companies and registered investment companies, could result from the burden of complying with disclosure requirements.[147] Specifically, the SEC contrasted one commenter's concern about the costs of including shareholder solicitations, with the findings from a questionnaire pertaining to the promulgation of Rule 14a-8[148] in 1997.[149] The results of the questionnaire iterated that respondent companies

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[143] *Id*. By increasing spending and resources to oppose and defeat shareholder nominees, diverted resources are deprived from being employed in the company's operations.

[144] *Id*. For example, shareholders would have to race to file their Schedule 14Ns to get their nominee in the company's proxy materials because only the first shareholder or group will succeed. Furthermore, if the maximum number of shareholder nominees is already serving on the board, the company is not required to include additional shareholder nominees in its proxy materials. *Id*.

[145] *Id*. at 29,075–76; *see* Fisch, *supra* note 107, at 474. Premised on a comment the SEC received when considering a similar rule in 2003, the SEC forecasted that approximately 97 proposals might be submitted to companies each year and roughly 90% of companies would prepare and submit a notice of intent to exclude these proposals. The SEC estimated that approximately 4,241 hours and $565,500 would be expended by companies for accomplishing this work. Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,076,

[146] *Id*.

[147] *Id.*

[148] Rule 14a-8 pertains to the inclusion of shareholder proposals within company proxy materials that contained a shareholder's recommendation or requirement that a company take a particular action.

[149] *Id.* at n.366.

believed that these costs were closer, on average, to $50,000.[150] The cost analysis concluded by projecting that the Proposed Rule and its amendments would likely have had little to no impact on small entities because such companies tend to receive very few shareholder proposals.[151]

3. Adopting Release for Exchange Rule 14a-11

The SEC adopted Exchange Act Rule 14a-11 ("Rule 14a-11") with "significant modifications" as a result of the comments it received during the comment period.[152] The applicability of the rule and its scope did not change from the Proposed Rule, although required ownership thresholds and certain provisions relating to the actual use of Rule 14a-11 did change.[153] The SEC discarded the tiered threshold ownership requirements and instead instituted the requirement that a nominating shareholder or group own at least 3% of the voting power of its company's securities.[154] The requirement for continued ownership through the date of the meeting, and the requisite intent not to change the control of the company, remained the same.[155] Additionally, the SEC changed the requisite holding period from one year, as recommended in the Proposed Rule, to three years in the final rule.[156] This change arose from comments that expressed concern for shareholders being guided by motives contrary to those of the company.[157] Moreover, the final rule was consistent with the Proposed Rule's assertion that a company does not need to include more than one shareholder nominee or a number of nominees that represents up to 25% of the company's board of directors,

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[150] *See id.* at 29,076–77, n.368. In addition to the extra costs of including these materials, the SEC also believed that a company would incur additional costs stemming from solicitations by both companies and shareholders to support or oppose certain nominees. *Id.* at 29,077.
[151] *Id*.
[152] Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668, 56,674 (Sept. 16, 2010) (to be codified at 17 C.F.R. pt. 240).
[153] *Id*. at 56,674–75.
[154] *Id.*; *see also* Fisch, *supra* note 107, at 447.
[155] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,675.
[156] *Id.*; *see also* Fisch, *supra* note 110, at 447.
[157] *See* Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,697.

whichever one is greater, in the company's proxy materials.[158] The SEC also modified the rule's priority of nominations when more than the required amount is received. In the Proposed Rule, the original order was determined by who submitted their nomination first;[159] a first-come, first-served standard was nearly unanimously opposed for various reasons.[160] As a result, the SEC redesigned the order priority for shareholder nominees on the voting percentage of shareholders who submit nominations.[161]

Although the SEC received hundreds of comments on various aspects of the Proposed Rule, comments regarding the application of cost-benefit analysis will be addressed in the following section. The SEC initially focused on the direct cost savings expected from the enactment of Rule 14a-11. Compared with the costs of traditional proxy contests, Rule 14a-11 was believed to result in direct cost savings for shareholders due to reduced printing and postage costs and reduced expenditures for advertising and promotion.[162] Commenters, however, were primarily concerned that Rule 14a-11 would not reduce overall costs, but would instead merely shift costs onto the company.[163] Yet, relying exclusively on a comment from the 2003 proposal, the SEC insisted that any increased costs to the company would not be as much as would otherwise occur in a traditional proxy contest.[164]

The asserted benefit that attracted volumes of comments and drew the most criticism was that Rule 14a-11 had the potential to

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[158] *Id*. at 56,675; *see also* Fisch, *supra* note 110, at 445.
[159] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,710.
[160] *Id*. at 56,710–11 (summarizing many of the comments submitted objecting to the first-come, first-served proposal and the "small number" of comments supporting it).
[161] *Id*. at 56,711. Therefore, in cases where there are more nominees than spots required by the rule, those shareholders with a higher voting percentage would get preference for their nominees.
[162] *Id*. at 56,756.
[163] *See id*. at 56,757.
[164] *Id*. at n.875 (referencing Letter from Stephen M. Bainbridge submitted in connection with the 2003 proposal (File No. S7-19-03)). Part of the SEC's discount may be attributed to the relative benefits of streamlining all nominees into the company's proxy material as opposed to shareholders receiving several sets of proxy materials from both the company and other shareholders who had to solicit and distribute their own under traditional proxy contests.

result in improved board and company performance.[165] The SEC admitted that the empirical evidence appeared mixed, but ultimately concluded that, when reviewed in their totality, data supported the potential for improving board and company performance.[166] Indeed, the SEC analyzed studies that both supported and contradicted the conclusion that an increased share of dissident directors would increase company value.[167] The contradictory studies warned that compliance with Rule 14a-11 would be distracting, time-consuming, and inefficient.[168] However, the SEC ultimately discounted these contradictory findings because of "questions raised by other studies, limitations acknowledged by the studies' authors, or their own concerns about the studies' methodology or scope."[169] In support of its position, the SEC asserted that facilitating shareholders' ability to include their director nominees within the company proxy materials could produce an increased pool of directors from which to draw.[170] Lastly, the SEC addressed the idea that more informed voting decisions in director elections would occur due to improved disclosure of shareholder nominees.[171]

The SEC identified the same three costs in Rule 14a-11 as it did in the Proposed Rule.[172] The first cost pertaining to "potential adverse effects on company and board performance" received a

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[165] *Id*. at 56,760 (describing some of the "significant comments" received regarding this assertion). Most commenters agreed that Rule 14a-11 had the *potential* to increase accountability, but many worried at what cost such accountability could be achieved.

[166] *Id*. at 56,761.

[167] *Id*. at 56,762. The notion being that shareholder nominees who are elected to the board would be more likely to dissent, as compared to directors who are nominated by company management.

[168] *See id.*; *see also* Fisch, *supra* note 107, at 477.

[169] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,762–63.

[170] *Id.* at 56,764.

[171] *Id*. This asserted benefit was not grounded in any quantifiable data, but instead discussed the qualitative benefits of increased communication amongst shareholders through a refined proxy process.

[172] *Compare* Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668, 56,764 (Sept. 16, 2010) (to be codified at 17 C.F.R. pt. 200, 232, 240 and 249), *with* Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29,024, 29,074 (proposed June 18, 2009) (to be codified at 17 C.F.R. pt. 200, 232, 240 and 249).

significant number of comments.[173] The SEC acknowledged that many comments expressed concern about the potential distraction and time-consuming work that companies and boards may face in light of Rule 14a-11.[174] Yet, the Commission asserted that such concerns were not necessarily associated with promulgation of Rule 14a-11 as such, but were actually "associated with the traditional state law right for shareholders to nominate and elect directors."[175]

Commenters questioned whether unqualified individuals would be nominated for election without undergoing the vetting process that is required of director nominees.[176] While the SEC never directly addressed this concern, the Commission stated that the rule would only require inclusion of nominees in proxy materials, but not elections.[177] Instead, the SEC attempted to alleviate concerns for potential costs associated with changing company procedures by highlighting the modifications made to the Proposed Rule to better streamline certain requirements (i.e., creating a single three percent ownership threshold instead of a tiered system).[178]

Lastly, the SEC considered the "costs related to preparing disclosure, printing and mailing, and costs of additional solicitations

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[173] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,765.

[174] *Id*. In addition to this concern, some comments addressed the additional resources and costs that may be expended to institute policies and procedures to better address shareholders concerns.

[175] *Id*. The SEC was convinced that certain factors would lower the costs that these comments asserted. One of these factors was the assertion that shareholders may "understand that the board's time and other resources are in scarce supply and will take these considerations into account in deciding to nominate directors . . . ." Following this assertion, the SEC conceded that companies may incur costs in reexamining and adjusting its current procedures; however, the SEC then explicated that these costs may be limited to the extent that the new rule improves the overall efficiency of the director nomination process. No empirical data was provided and no reference was made to it being unavailable.

[176] *Id*.; *cf.* Fisch, *supra* note 107, at 459–460.

[177] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,765–66. This concern was originally limited to the extent that shareholders would "understand that experience and competence are important director qualifications . . . ." The SEC proceeded to acknowledge that the vast requirements that are necessary for Rule 14a-11 to go into effect and the difficulty that may be endured in applying it to companies with dynamic capital structures may create a complex situation, imposing severe costs on the company.

[178] *Id*. at 56,772, 56,780.

and shareholder proposals."[179] Explaining that Rule 14a-11 would impose direct economic costs on both the company and the shareholder, the SEC identified costs that could be incurred by the company in providing notice of any exclusion of certain shareholder nominees because of any eligibility or procedural deficiencies.[180] As the SEC did in the Proposed Rule, it addressed the potential increase in incremental cost of printing and mailing, and then discussed the potential costs from soliciting activities by either the company or shareholders.[181]

The SEC asserted two factors that might limit concerns raised in comments. The first limiting factor was that "directors' fiduciary duties [might] prevent [the board] from using corporate funds to resist shareholder nominees."[182] The second limiting factor was that the total number of shareholder nominees that might be included in the proxy materials would be limited.[183] In other words, the SEC attempted to curb concerns for costs by explaining that Rule 14a-11 is limiting in-and-of-itself, since it caps the total number of shareholder-nominees a company must consider and include in proxy materials. The remainder of the identified costs pertained to the effect that Rule 14a-11 might have on investment companies in particular.

4. Business Roundtable

Business Roundtable v. SEC marks the third time within the past six years that the D.C. Circuit struck down an SEC rulemaking for failure to adequately consider the statutory and economic impacts of proposed regulation.[184] The court found five specific deficiencies

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[179] *Id.* at 56,768.
[180] *Id.*
[181] *Id.* at 56,769–70. The SEC received a tremendous amount of comments concerning the extent to which companies will solicit against the election of shareholder nominees. This concern was expressed in the discussion of potential benefits of Rule 14a-11 as well. Some comments projected that larger companies might spend $4 million to $14 million to oppose shareholder nominees, and smaller companies could spend approximately $800,000 to $3 million.
[182] *Id.* at 56,770. Some commenters resisted this notion by claiming that these same fiduciary duties may compel directors to oppose certain shareholder nominees.
[183] *Id.*
[184] 647 F.3d 1144, 1148 (D.C. Cir. 2011).

in the SEC's consideration of the costs and benefits in promulgating Rule 14a-11.

First, the D.C. Circuit held that the SEC did not "appreciate the intensity with which issuers would oppose shareholder nominees."[185] The petitioners argued that the SEC acted in an arbitrary and capricious manner for failing to "estimate the costs of solicitation and campaigning that companies would incur to oppose candidates nominated by shareholders."[186] The SEC provided two theorems rebutting commenter concerns regarding exorbitant costs. First, the SEC believed a company's fiduciary duty to shareholders would prevent a company from using corporate funds to resist shareholder nominations for "no good-faith corporate purpose[s]."[187] Second, the SEC believed the requisite ownership and holding requirements to use Rule 14a-11, as well as the limitation on the number of shareholder director nominations a board can receive, would also limit the resources expended by corporations to oppose these nominees.[188]

Addressing the SEC's belief that costs associated with Rule 14a-11 would be limited in these two respects, the D.C. Circuit ruled that the SEC had "no basis beyond mere speculation" to assume such limitations because the SEC presented no practical evidence that fiduciary obligations would cause company directors to oppose shareholder nominations.[189] The D.C. Circuit ultimately concluded that the "[SEC] did nothing to estimate and quantify the costs it expected companies to incur; nor did it claim estimating those costs was not possible, for empirical evidence about expenditures in traditional proxy contests was readily available."[190] The court's conclusion implies that the SEC should have analyzed the costs that companies currently incur as a result of resisting shareholder nominees in traditional proxy contests, and extrapolated from these estimates what the costs might have been under Rule 14a-11.

Second, the D.C. Circuit ruled that "the SEC [had] relied upon insufficient empirical data when it concluded that Rule 14a-11 would improve board performance and increase shareholder value by

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[185] *Id.* at 1149.
[186] *Id*. at 1149–50 (specifying that especially when the SEC received comments that these costs could be enormous).
[187] *Id*. at 1149.
[188] *Id*.
[189] *Id*. at 1150.
[190] *Id.*

facilitating the election of dissident shareholder nominees."[191] Comments presented to the SEC included extensive studies vehemently disagreeing with the SEC's proposition.[192] However, the SEC dismissed these concerns and relied exclusively on two studies: one focusing on "hybrid boards," and another concerning the effect of proxy contests in general, upon shareholder value.[193] The D.C. Circuit found both studies "unpersuasive" and ruled that the SEC had inappropriately discounted those studies submitted by commenters.[194] In response, the SEC stated that these studies were summarily discounted "because of questions raised by subsequent studies, limitations acknowledged by the studies' authors, [and the Commission's] own concerns about the studies' methodology or scope."[195] The D.C. Circuit held that the SEC did not sufficiently support its conclusion and that it "relied on mixed empirical data," while rejecting other data because of stated limitations.[196]

Third, the D.C. Circuit found that the SEC had improperly discounted the costs of Rule 14a-11.[197] Many comments suggested that the promulgation of Rule 14a-11 would impose several costs on companies. However, the SEC attempted to point out that these alleged costs were more directly tied to the state law shareholder right to nominate directors, and not a cost that resulted from a change in federal proxy rules.[198] The D.C. Circuit rejected the SEC's distinction and ruled that it had "fail[ed] to view a cost at the margin."[199] Relying on its prior decision in *Chamber of Commerce*,

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[191] *Id.*; *see also* Hayden, *supra* note 106, at 121.
[192] *Bus. Roundtable*, 647 F.3d at 1150–51. These comments conversely argued that dissident shareholder nominees would have a negative effect on board performance.
[193] *Id.* at 1151. Hybrid boards are corporate boards are, by definition, "composed of a majority of incumbent directors and a minority of dissident directors." Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56, 667, 56, 762 (Sept. 16, 2010).
[194] *Bus. Roundtable*, 647 F.3d at 1151; *see also* Recent Case, *D.C. Circuit Finds SEC Proxy Access Rule Arbitrary and Capricious for Inadequate Economic Analysis*: Business Roundtable v. SEC, 125 HARV. L. REV. 1088, 1091 (2012) [hereinafter Business Roundtable Recent Case].
[195] *Bus. Roundtable*, 647 F.3d at 1151; see *also* Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,762.
[196] *Bus. Roundtable*, 647 F.3d at 1151; *cf.* Hayden, *supra* note 106, at 121.
[197] *Bus. Roundtable*, 647 F.3d at 1151.
[198] *Id.*
[199] *Id.*

the D.C. Circuit held that the SEC's distinction was "illogical and, in an economic analysis, unacceptable."[200] The court reiterated a bright line rule that, even if a cost is objectively created by another rule or regulation that already exists, it does not excuse adequate consideration of that cost should it be affected or exacerbated by a new rule.[201]

Fourth, the D.C. Circuit found that the SEC had failed to consider the effect of Rule 14a-11 on shareholders with special interests who might use it as a means to gain concessions and leverage from companies.[202] The court stated that "by ducking serious evaluation of the costs that could be imposed upon companies from use of the rule by shareholders representing special interests, particularly union and government pension funds . . . [the SEC had] acted arbitrarily."[203] While the SEC properly acknowledged that the eligibility requirements to use Rule 14a-11 should prevent these shareholders with special interests from pursuing such tactics, the SEC did not fully explore this grave concern expressed by commenters. The D.C. Circuit held that the SEC had failed even to attempt quantifying the effects of Rule 14a-11, and could not simply provide theoretical reasons for why abuse by shareholders with special interests would not occur.[204]

Finally, although the D.C. Circuit disagreed with the petitioners and found that the SEC did not unreasonably scale back its estimates of how many companies would use Rule 14a-11, the court concluded that the SEC's discussion of the estimated frequency of nominations under the new rule was internally inconsistent.[205] This issue is very similar to the SEC's improper discounting of the rule's likely costs. The SEC did estimate the number of elections it expected under Rule 14a-11; however, the estimate fluctuated throughout the adopting release and was usually quite high when

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[200] *Id.*; *see also Chamber of Commerce*, 412 F.3d 133, 143 (D.C. Cir. 2005).
[201] *See Bus. Roundtable*, 647 F.3d at 1151; *see also Chamber of Commerce*, 412 F.3d at 143 (rejecting SEC's argument that the rule would not create "costs associated with the hiring of staff because boards typically already have this authority under state law).
[202] *Bus. Roundtable*, 647 F.3d at 1151–52.
[203] *Id.* at 1152.
[204] *Id.*
[205] *Id.*; *see also* Business Roundtable Recent Case, *supra* note 192.

referred to in the discussion of benefits of Rule 14a-11, and quite low in the discussion of costs.[206]

D. The SEC's Response to Judicial Challenges

In response to the invalidation of rulemakings for failed cost-benefit analysis, the SEC reorganized its internal structure to better address the quality of its section 3(f) analyses.[207] In September 2009, the SEC created the Division of Risk, Strategy, and Financial Innovation ("RSFI").[208] This was done in order to "integrate financial economics and rigorous data analytics into the core mission of the SEC."[209] Some of the listed activities of RSFI include "providing detailed, high-quality economic and statistical analyses, and specific subject-matter expertise to the [SEC] and other Divisions/Offices."[210]

On March 16, 2012, RSFI, in partnership with the SEC's Office of General Counsel ("OGC") published a memorandum detailing the Commission's "current guidance on economic analysis in SEC rulemakings."[211] In the memorandum, RSFI and OGC stated that, due to "recent court decisions, reports of the U.S. Government Accountability Office ("GAO") and the SEC's Office of Inspector General ("OIG")," several improvements needed to be made to the SEC's economic analysis in its rulemaking.[212] Altogether, the memo identifies four essential areas for improvement: (1) improving the recognition of areas requiring rulemaking; (2) better articulating economic baselines (from which comparisons regarding impact may be drawn); (3) exploring economically viable alternatives to proposed rules and regulations; and (4) assessing a rule's economic consequences.[213]

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[206] *Bus. Roundtable*, 647 F.3d at 1153–54.
[207] *The Division of Risk, Strategy, and Financial Innovation*, THE U.S. SECURITIES AND EXCHANGE COMMISSION, http://www.sec.gov/divisions/riskfin.shtml (last visited Dec. 15, 2011).
[208] *Id.*
[209] *Id.*
[210] *Id.*
[211] Division of Risk, Strategy and Financial Innovation, U.S. Securities and Exchange Commission, *Memorandum on Current Guidance on Economic Analysis in SEC Rulemakings* (Mar. 16, 2012), http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.
[212] *Id.*
[213] *Id.* at 1–2.

In order to find the appropriate balance between free market policing and federal oversight, "rule releases must include a discussion of the need for regulatory action."[214] The most concrete example of objective reasoning for proposing a rule would be a Congressional directive to do so.[215] However, the SEC also acknowledges additional reasons justifying regulatory action; proposed rules may represent a response to a market failure, an attempt to improve government processes, or even an interpretation of a statutory provision.[216] Regardless of the reason presented, though, the SEC only needs to identify a single appropriate motive for economic analysis to withstand judicial scrutiny.[217]

Second, the SEC requires that staff members of the rule-making teams measure the economic consequences of a proposed rule against a baseline.[218] The SEC analogizes the baseline to "how the world would look in the absence of the proposed action."[219] Therefore, proper economic analysis compares "the current state of the world (still including the problem the proposed rule is designed to address), to the expected state of the world with the proposed regulation in effect."[220] To properly assess the current economic baseline, the SEC staff is directed to work closely with RSFI economists, which allows staff to adequately appreciate the assumptions underlying any relevant baselines.[221]

Generally speaking, an agency rulemaking is a discretionary practice born of an amalgamation of choices. Thus, a proposed rule should identify and discuss reasonable alternatives to its own approach, including less stringent regulatory structures, or regimes of even greater regulation.[222] However, at the behest of judicial

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[214] *Id.* at 5.
[215] *Id.* at 6.
[216] *Id.* at 5.
[217] *Id.*
[218] *Id.* at 6.
[219] *Id.*
[220] *Id.*
[221] *Id.*
[222] *Id.* at 8–9. Reasonable alternatives do not include those that cannot be implemented by the issuing agency. For example, should a reasonable alternative present itself to the SEC regarding the swap space, as the CFTC and not the SEC is the federal regulator in that jurisdiction, the SEC would not need to discuss the alternative in the proposed rulemaking. Many times, however, should the alternative exist in a contextually similar regulatory

guidance, the SEC is not required to address *every* alternative, but only those that are *reasonable* in nature; thus, the agency "must either consider those alternatives or give some reason . . . for declining to do so."[223] The issue that remains is what is reasonable and how the SEC makes such a determination.

When the SEC analyzes the likely consequences of a proposed rule, and any alternative regulatory approaches, attorneys and RSFI economists are instructed to explicate and quantify the most likely economic benefits and costs, while also recognizing the methods and shortcomings of such predications, and provide some explanation for costs and benefits that have *not* been included, but might be reasonably expected.[224] Insofar as it is practical, the SEC, together with RSFI, is also expected to address "ancillary economic consequences."[225]

In addition to working with RSFI economists to identify the potential economic benefits and costs of the proposed rulemaking, SEC guidance directs the staff to "monetize or otherwise quantify potential costs and benefits of the rule whenever such quantification is practicable" and discuss the methodology of the quantification used.[226] Timing associated with quantifying these potential benefits and costs is the most crucial concern of the rulemaking staff.[227] To ensure that quantification of the potential benefits and costs is adequately conducted in the proposed rule, the staff, to the extent possible, should identify "any specific data that would be necessary for or that would assist in quantification."[228] If the rule writing staff, in conjunction with RSFI economists, is unable to quantify the anticipated economic costs and benefits, it must provide explanations

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space, agencies may jointly release a proposed rule so as to adequately cover the alternatives and its effect on the rule.

[223] *Id.* at 9.

[224] *Id.* at 9–10.

[225] *Id.*

[226] *Id.* at 12.

[227] *Id.* (detailing that RSFI economists should be included in the rule making process as soon as possible so as to help identify where quantification will be possible and required). Thus, if RSFI economists are brought into the rule making in a stage of infancy, should data for the rule making need to be developed, it is now feasible, if not required, the SEC present the public with such data. Lastly, should the SEC be incapable of creating or finding such data, the proposed release should make a request for such data and address the results of the analysis in the adopting release.

[228] *Id.*

as to why quantification is not practicable and include a qualitative analysis of the likely economic consequences of the proposed rule.[229]

Going forward, rulemakings under Dodd-Frank and the JOBS Act,[230] among other pieces of legislation, will contain many features that the SEC and Congressional Oversight Committee deem necessary to validate a SEC rule.[231] Whether the judiciary agrees with such measures remains to be seen. At the very least, SEC rulemakings required by Dodd-Frank and the JOBS Act will satisfy the Congressional mandate that the SEC enact such rules, though the Commission will still be expected to carefully identify and explain all assumed economic baselines, as well as discretionary determinations of staff.[232] The SEC will also be required, naturally, to address all reasonable alternatives and approaches to the proposed rulemaking, including those reasonable alternatives identified during the official comment phase by non-staff.[233]

[229] *Id.* at 13–14. Furthermore, SEC guidance specifically states that "[c]ourt decisions addressing the economic analysis in the [SEC] rules have likewise stressed the need to attempt to quantify anticipated costs and benefits, even where the available data is imperfect and where doing so may require using estimates (including ranges of potential impact) and extrapolating from analogous situations." *Id.* This demonstrates the importance of the SEC attempting to quantify the costs and not simply relying on qualitative reasoning.

[230] Jumpstart Our Business Startups Act, H.R. 3606, 112th Cong. (2012).

[231] Chairman Mary Schapiro explained the beneficial interaction between the Government Accountability Office ("GAO") and the SEC when reviewing the agency's use of cost-benefit analysis in rulemakings when she testified before the House Oversight Committee: "While these [GAO] reviews found that the Commission engages in a systematic approach to cost-benefit analysis in rulemaking, they also provided useful *direction* for improvement in our processes." Testimony concerning Economic Analysis in SEC Rulemaking before the Subcomm. on TARP, Financial Services and Bailouts of Public and Private Programs Oversight and Government Reform Comm., U.S. H. of Rep. (Apr. 17, 2012), *available at* http://oversight.house.gov/wp-content/uploads/2012/04/4-17-12-Schapiro-Testimony.pdf (last visited Oct. 5, 2012) (Testimony of Mary L. Schapiro, Chairman, U.S. Securities and Exchange Commission) (emphasis added).

[232] *Memorandum on Current Guidance*, *supra* note 209, at 11–12.

[233] *Id.* at 15.

IV. Commodity Futures Trading Commission Cost-Benefit Analysis

A. Statutory Basis & Legislative History

Like the SEC, the CFTC is also subject to a cost-benefit analysis requirement, as found in section 15(a)(1) of the Commodity Exchange Act ("CEA").[234] The CEA provides that the CFTC's cost-benefit analysis should include considerations of: (1) the public good and the protection of market participants; (2) efficiency, competiveness, and the financial integrity of futures markets; (3) price discovery; (4) the importance of sound risk-management techniques; and (5) other public interest considerations.[235]

The Commodity Futures Modernization Act of 2000 ("CFMA") added section 15(a) to the CEA.[236] The CFMA largely deregulated the derivatives industry, so it is logical that it imposes a cost-benefit requirement on CFTC rulemaking.[237] At the same time, though, there is scant evidence in the legislative record of the CFMA to explain Congress's motivation in inserting a cost-benefit requirement on the CFTC. Indeed, it was not until 2001, when the CFTC first issued a proposed rule, that the cost-benefit analysis requirement took shape.[238] However, this rulemaking merely provided a short discussion of these five factors and qualitatively analyzed, very briefly, the potential costs and benefits.[239] Later, the CFTC actually began to combine section 15(a) analysis with PRA analysis in both proposed and final rulemakings.[240] It was not until

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[234] 7 U.S.C. § 19(a)(1) (2012).
[235] *Id*. § 19(a)(2).
[236] Commodity Futures Modernization Act of 2000, H.R. 5660, 106th Cong. § 119 (codified as amended in scattered sections of 7 U.S.C.).
[237] *See* Phil Gramm, Editorial, *A Bill That Was No Midnight Surprise*, WASH. POST, Oct. 10, 2008, at A18.
[238] OFFICE OF THE INSPECTOR GEN., COMMODITY FUTURES TRADING COMM'N, A Review of Cost-Benefit Analysis Performed by the Commodity Futures Trading Commission in Connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act (2011) at 2, *available at* http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/oig_investigation_061311.pdf.
[239] *Id*.; *see also* A New Regulatory Framework for Trading Facilities, Intermediaries and Clearing Organizations, 66 Fed. Reg. 14,262 (proposed Mar. 9, 2001).
[240] *See* OFFICE OF THE INSPECTOR GENERAL *supra* note 236, at 2242.

recently that the CFTC started to raise concerns about current cost-benefit analysis practices and issued internal guidance.[241]

The CEA is clearer and more precise in laying out the cost-benefit analysis requirements for the CFTC when promulgating a rule than the language provided in the SEC's organic statute.[242] Although the second area that the CFTC must consider in its cost-benefit analysis—the consideration of the *efficiency,* competitiveness, and the financial integrity of futures markets—is extremely similar to the requirements of the Exchange Act,[243] the CEA's overall language imposes a more precise analysis of a rule's effect in five specific areas.[244] Additionally, unlike the SEC's requirement, the last area specified in the CEA—"[and] other public interest considerations"—serves as a catchall for any other type of consideration that could arguably be important to the public interest.[245] Despite the fact that the language of the CEA is extremely similar to the Exchange Act, the CEA's greater precision and detailed requirements for cost-benefit analysis may impose a higher standard on the CFTC than that imposed on the SEC.[246]

B. *Business Roundtable's* Effect on the CFTC

The series of D.C. Circuit cases decided against the SEC in the past decade have brought the present day requirements of cost-benefit analysis under heightened judicial scrutiny.[247] In light of

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[241] *Id.*

[242] 15 U.S.C. § 78c(f) (2006).

[243] *Compare* 15 U.S.C. § 78c(f) (2006)*, with* 7 U.S.C. § 19(a) (2006).

[244] 7 U.S.C. § 19(a) (2006).

[245] *Id.*

[246] *See generally* Peter Madigan, *CFTC and SEC Facing Legal Anxiety Over Cost-Benefit Analyses*, RISK MAGAZINE (Oct. 3, 2011), http://www.risk.net/risk-magazine/feature/2111501/cftc-sec-facing-legal-anxiety-cost-benefit-analyses (stating the language of Section 15(a) is "similar to that binding the SEC, but the absence of the term 'capital formation' is interpreted by some attorneys to mean legal challenges to CFTC rule-makings may need to meet a higher judicial standard to be successful").

[247] *See generally* Bus. Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011); Am. Equity Inv. Life Ins. Co. v. SEC, 613 F.3d 166 (D.C. Cir. 2010); Chamber of Commerce v. SEC, 412 F.3d 133 (D.C. Cir. 2005).

these decisions against the SEC,[248] and the greater specificity for cost-benefit analysis contained in section 15(a) of the CEA, the CFTC should be concerned with the real possibility that courts may hold the CFTC to an even tougher standard when it undertakes its cost-benefit analysis.[249]

1. Recent Complaint Against CFTC

In December 2011, the International Swaps and Derivatives Association[250] and the Securities Industry and Financial Markets Association[251] (collectively "Complaining Parties") filed a complaint against the CFTC, stating that its new position limit rule "was poorly crafted . . . and absent any sound economic or cost-benefit analysis."[252] This complaint marked the first-ever legal challenge to a

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[248] The decisions against the SEC are important to the CFTC because the CFTC frequently collaborates with, and shares overlapping regulatory space with, the SEC. This is cooperation is further evidenced by Dodd-Frank's requirements for several joint-rulemaking efforts. For example, both agencies were required to co-write the new definitions for swap regulation. *See, e.g.*, Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 Fed. Reg. 30,596 (final rule announced May 23, 2012) (codified at 17 C.F.R. pt. 240).

[249] *E.g.*, Brian Scheid, *CME: Dodd-Frank Rules Vulnerable to Legal Challenge*, PLATTS COAL OUTLOOK, MARKETSCOOP, vol. 35, no. 36, at 3 (citing CFTC Commissioner Jill Sommers's criticism that the agency lacks a "robust" cost-benefit analysis).

[250] The International Swaps and Derivatives Association works to make the over-the-counter derivatives markets safe and efficient. It is a member association that currently has over 835 members across the globe. It works to "reduce[] counterparty credit risk, increase[e] transparency, and improve[e] the industry's operational infrastructure." INT'L SWAPS AND DERIVATIVES ASS'N, http://www2.isda.org/ (last visited Mar. 22, 2013).

[251] "[The] Securities Industry and Financial Markets Association represents the shared interests of securities firms, banks, and asset managers. It seeks to develop policies and practices which strengthen financial markets, encourage capital availability, job creation, and economic growth while building trust and confidence in the financial industry." SEC. INDUS. AND FIN. MKT. ASS'N, http://www.sifma.org/ (last visited Mar. 22, 2013).

[252] Katy Burne & Jamila Trindle, *Wall Street, CFTC Face Off*, WALL ST. J., Dec. 3, 2011, at B5.

CFTC rulemaking under Dodd-Frank.[253] The complaint alleged several violations committed by the CFTC when it promulgated the position limit rules, including a violation of the CEA for conducting an "insufficient evaluation of costs and benefits."[254] Specifically, the complaint stated that the CFTC "ignored substantial evidence submitted by commenters demonstrating the rule . . . would have significant and systemic adverse effects on the commodity markets."[255] It further alleged that the CFTC, when faced with "overwhelming evidence" that the rule would impose tremendous costs on market participants, failed to "collect data that would enable it to fairly evaluate the costs of the rule."[256] Finally, the Complaining Parties suggested that the CFTC offered only "short, conclusory assertions" when it addressed the effect of the new rule on market liquidity and price discovery.[257]

Although the lawsuit also challenged whether position limits were statutorily mandated under Dodd-Frank, it was especially desirable for a decision to provide essential insight as to how the CFTC must perform cost-benefit analysis in conjunction with a Congressionally-mandated standard.[258] This case would have demonstrated, then, just how far the courts would be willing to dictate and scrutinize the methods employed by agencies in conducting cost-benefit analysis. Furthermore, if the court resolved the cost-benefit issue, it would hopefully have provided the CFTC with guidance as to the process it should employ when attempting to regulate a previously unregulated area.

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[253] ISDA and SIFMA Attack Position Limits in First Challenge to CFTC Rulemaking Under the Dodd-Frank Act, SUTHERLAND, REGULATORY REFORM TASK FORCE LEGALALERT, Dec. 7, 2011, http://www.regulatoryreformtaskforce.com/files/News/73e3c364-5e12-48a4-b980-6856b6083d9f/Presentation/NewsAttachment/b1e5486f-e3c1-4b8b-96fe-68667f90857f/RRTFAlert12.7.11.pdf (stating that ISDA and SIFMA's lawsuit is the first lawsuit challenging the CFTC's rulemaking power under the Dodd-Frank Act).

[254] Complaint at 27, Sec. Indus. and Fin. Mkt. Ass'n v. CFTC, No. 1:11-cv-02146 (D.D.C. Dec. 2, 2011) ("Count Two: Violation of the Commodity Exchange Act—Insufficient Evaluation of Costs and Benefits").

[255] *Id.* at 28.

[256] *Id.*

[257] *Id.*

[258] It should be noted that the Complaining Parties are also challenging whether the CFTC was mandated by Congress to impose position limit rules. *See id*. at 26–27.

Unfortunately, the U.S. District Court for the District of Columbia struck down the CFTC Position Limits Rule on September 28, 2012 without addressing the cost-benefit analysis.[259] The court found that position limits were not statutorily mandated by Dodd-Frank and that the CFTC had failed to determine that "position limits are necessary to 'diminish, eliminate, or prevent' the burden described in § 6a(a)(1)" prior to promulgating the Position Limits Rule.[260] It is unclear whether the CFTC will appeal this ruling, but for now it appears that the D.C. Circuit has avoided an opportunity to provide greater clarity to this process.[261]

2. CFTC Cost-Benefit Analysis Going Forward

It should be clear that the CFTC is attempting to regulate an industry that historically has never been regulated.[262] Because of the absence of regulation heretofore, industry participants have never been required to submit information pursuant to recordkeeping and reporting requirements.[263] As such, the only insight and data that the CFTC possesses has come from the public comments it receives.[264]

In certain situations, the CFTC might rely more heavily on a large volume of comments when deciding the shape of a final rule; this was the case with the CFTC's recent position limit rules, where

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[259] Int'l Swaps & Derivatives Ass'n v. CFTC, Civ. Action No. 11-cv-2146 (RLW), 2012 U.S. Dist. LEXIS 139788, at *55 (D.D.C. Sept. 28, 2012) ("The Court declines, however, to reach a determination on whether the aggregation standards promulgated in the final rule are arbitrary and capricious under 5 U.S.C. § 706(2)(A) or in violation of the cost-benefit analysis requirements of 7 U.S.C. § 19.").

[260] *Id.* at *30.

[261] Ben Protess, *Regulator Urges Appeal of Dodd-Frank Court Ruling*, N.Y. TIMES, Oct. 2, 2012, http://dealbook.nytimes.com/2012/10/02/regulator-urges-appeal-of-dodd-frank-court-ruling/.

[262] In terms of the swaps markets, the CFTC is attempting to bring visibility and create physical forums to facilitate trading of these instruments that previously took place in informal and private channels. OFFICE OF THE INSPECTOR GENERAL, *supra* note 236, at iii.

[263] *See* Dodd-Frank Act, Pub. L. No. 111-203, § 728, 124 Stat. 1376, 1697–1701 (2010).

[264] The purpose of a notice and comment process in rulemakings is to give the agency insight into who will be affected by regulation and the extent of that effect. *See* Administrative Procedure Act § 553, 5 U.S.C. § 553 (2012).

the CFTC received 15,116 comments.[265] However, the position limit rules were both contentious and controversial rulemakings, which account for the heightened level of public participation.[266] CFTC rulemakings garner few public comments more often than not, as was demonstrated during the comment period for the commodity options rule, during which the CFTC received only 39 substantive comments.[267] Additionally, receipt of a large number of comments does not necessarily translate into a large amount of substantive information. Therefore, relying solely on public comments to provide reliable and insightful information is not only risky, but also cursory, because of the uncertainty as to how many comments the agency might receive.

Most criticisms of CFTC cost-benefit analysis surround the issue of quantification in rulemakings; two vocal critics of the lack of quantification in current rulemakings are Commissioners Scott D. O'Malia and Jill E. Sommers.[268] Commissioner Sommers voiced her concern, stating that "[w]hile [the CFTC] do[es] ask for comment from the public on the costs and benefits at the proposal stage, [it] rarely, if ever, attempt[s] to quantify the costs before finalizing a rule."[269] Commissioner O'Malia recently stated that he has "reached a tipping point and can no longer tolerate the application of such weak standards [in] analyzing the costs and benefits of [CFTC] rulemakings."[270] In addressing his dissatisfaction, Commissioner O'Malia sent a letter to OMB Director Jeffrey Zients to review the cost-benefit analysis employed by the CFTC in several rulemakings:

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[265] *See* Position Limits for Futures and Swaps, 76 Fed. Reg. 71,626, 71,626 (Nov. 18, 2011) (codified at 17 C.F.R. pts. 1, 150, and 151).
[266] Tom Schoenberg, *CFTC Position Limits Rule Lawsuit Dismissed by U.S. Appeals Court in D.C.*, BLOOMBERG, Jan. 20, 2012, http://www.bloomberg.com/news/2012-01-21/cftc-position-limits-rule-lawsuit-dismissed-by-u-s-appeals-court-in-d-c-.html.
[267] *See* Commodity Options, 77 Fed. Reg. 25320, 25322 (Apr. 27, 2012) (codified at 17 C.F.R. pts. 3, 32, and 33).
[268] *See infra* notes 267–68 and accompanying text.
[269] *The Costs of Implementing the Dodd-Frank Act: Budgetary and Economic: Hearing Before the Subcomm. on Oversight and Investigations, H. Comm. on Fin. Serv.*, 112th Cong. 3 (2011) (statement of Jill E. Sommers, Commissioner, CFTC).
[270] Scott D. O'Malia, Commissioner, CFTC, Opening Statement at Open Meeting on One Final Rule and One Proposed Rule (Feb. 23, 2012), http://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement022312.

> I believe the [CFTC] has failed to carefully and precisely identify a clear baseline against which the [CFTC] measured costs and benefits and the range of alternatives under consideration in this rule. Specifically, the [CFTC's] cost-benefit analysis with regard to this rule fails to comply with the basic direction in OMB Circular A-4 (the "Circular") to establish an appropriate baseline that includes an evaluation of the pre-statutory baseline in light of the range of [CFTC] discretion as to the manner in which the rules implement the statutory goals of section 4s. The Circular also directs the [CFTC] to consider alternatives available 'for the key attributes or provisions of the rule.' . . . The Circular goes on to recommend that, 'It is not adequate simply to report a comparison of the agency's preferred option to the chosen baseline.' Whenever you report the benefits and the costs of alternative options, you should present both total and incremental benefits and costs. . . . It is at this most basic level of analysis where the [CFTC] has failed to provide alternative options for consideration or has failed to justify its choice of regulation with a specific cost-benefit analysis.[271]

In addition to Commissioner O'Malia's request to the OMB, the CFTC has also reached out to OIRA.[272] The CFTC and OIRA entered into a memorandum of understanding that allows an OIRA staff member to assist with conducting the economic analysis of CFTC rulemakings.[273]

Ultimately, the CFTC must be wary of the accuracy of any quantitative information it receives from market participants who are

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[271] Letter from Scott D. O'Malia, Commissioner, CFTC, to Jeffrey Zients, Acting Director, Office of Mgmt. and Budget (Feb. 23, 2012), http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/omalialetter022312.pdf .

[272] Jamila Trindle, *CFTC Taps Help for Cost Analysis on New Rules*, WALL ST. J., May 10, 2012, http://online.wsj.com/article/SB10001424052702304070304577396192653277890.html.

[273] *Id.*

opposed to certain regulations.[274] Such a high degree of dependency for essential data on those who are more likely to possess interests contrary to the ultimate mission of the CFTC is not sound practice.[275] While the CFTC must meet the regulatory requirements of the APA, by addressing and considering all substantial comments made during the notice and comment period, the CFTC must also resolve to what extent it is necessary to independently quantify the effects of any potential regulation, and develop best methods for gathering this data. Furthermore, if such data simply does not exist, the CFTC must determine to what extent it should forecast the potential quantitative impact of new regulations. These are key questions that the CFTC needs to answer if it desires to improve the data and quantitative analysis available in its rulemakings. The lack of visibility into these markets should be fixed over time, as the initial recordkeeping and reporting requirements of early Dodd-Frank rulemakings start to run their course. However, until then, the CFTC faces uncertainty as to what lengths it must go to in order to compile this data. Even if the agency creates a division that is solely tasked with compiling and creating this data, the data may still ultimately not exist.

Regulating the abstruse swaps industry is increasingly more difficult for the CFTC today than it was for the SEC when it began regulating the equities markets in the 1930s.[276] When the SEC first started regulating the securities industry, the APA was in its infancy and the SEC did not yet have a cost-benefit analysis requirement.[277] Because of the absence of such procedural requirements, it was likely easier for the SEC to promulgate essential new rules governing the conduct of the markets and industry participants. The CFTC, however, is attempting to create and regulate new swaps markets in the face of burdensome procedural requirements.[278]

In order to better engage in economic analysis that can withstand judicial scrutiny, the CFTC has recently changed the composition of its rulemaking teams to include a staff person from

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[274] *Id.*
[275] *Id*.
[276] *See* Securities Exchange Rule 10b-5, codified at 17 C.F.R. § 240.10b-5. The APA was passed in 1946 and it was not until 1996 that the cost-benefit requirement was codified in the Securities Exchange Act by the National Securities Markets Improvement Act.
[277] *Id.*
[278] *See* Vt. Yankee Nuclear Power Corp. v. Natural Res. Def. Council, Inc., 435 U.S. 519, 524 (1978).

the Office of the Chief Economist.[279] Increasing the role of the Office of Chief Economist within rulemaking teams should lead to better economic analysis in CFTC rulemakings.[280] However, this change does not address the lack of visibility into these newly regulated markets and the shortage of data with which to inform decisions.[281]

Instead, the change in composition of rulemaking teams is analogous to hiring numerous experts in architecture to design and construct a building, yet without providing them with any of the necessary materials. Without the necessary "materials" and resources to build, the "structure" of a rulemaking cannot take "shape." Thus, as the CFTC is without good materials—that is, data—the cost-benefit analysis cannot take shape quantitatively within rulemakings.

Currently, the CFTC directs rulemaking teams to:

> (1) [R]espond to *meaningful* and *significant* comments received either on the specific Cost-Benefit section in the Propose Rulemaking or on the costs or benefits of the Proposed Rulemaking in general and how the comments informed the Final Rulemaking; (2) discuss the anticipated costs and benefits of the Final Rulemaking including whether such costs may be *meaningfully quantified*, as well as for other alternatives that would achieve the regulatory objectives, relative to the baseline, by evaluating reliable data if such data is available; (3) provide a clear explanation of why the Final Rulemaking is being adopted over the alternatives; and (4) discuss whether and how costs or benefits were quantified.[282]

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[279] OFFICE OF THE INSPECTOR GENERAL, *supra* note 236, at iii ("[T]he Office of Chief Economist will have a staff person on each rulemaking team, who will provide quantitative and qualitative input with respect to the costs and benefits of the final rulemaking, who should employ price theory economics or similar methodology to assess the costs and benefits of a rulemaking, and who will review each draft cost-benefit discussion.").

[280] *Id.*

[281] *Id.* at 7.

[282] Memorandum from Dan M. Berkovitz, General Counsel, CFTC, and Andrei Kirilenko, Chief Economist, CFTC, to CFTC Rulemaking Teams, at 11–12, 34 (May 13, 2011), http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/oig_investigation_061311.pdf.

While these recommendations provide CFTC rulemaking teams with a framework for conducting cost-benefit analysis, they are by no means an exhaustive compilation of considerations that rule makers must contemplate. To begin with, several of these recommendations are largely subjective due to the use of "meaningful" and "significant."[283] While one individual or rulemaking team may not consider certain comments meaningful or significant, others may consider them vastly meaningful or significant.[284]

This divergence has plagued administrative lawyers for years; however, in the cost-benefit context it is even more difficult because it requires more analysis than simply refuting comments on policy grounds. An attorney, or rulemaking team, must essentially put itself in the role of each and every commenter in an attempt to determine the meaningfulness of each comment.

A second determination that proves to be tremendously difficult in conducting cost-benefit analysis is whether a cost can be "meaningfully quantified."[285] The jurisprudence stemming from the above-mentioned SEC decisions seems to suggest that it is better for rulemaking teams to put forward their best guess than to dismiss the possibility of arriving at a conclusion obtained only through qualitative factorings.[286] The CFTC memorandum on guidance for cost-benefit analysis partially recognizes this implication when it suggests that if quantifiable data is not readily available or cannot be gained with specificity, "estimates or ranges *may* be used, provided there is a reasonable basis for such estimates or ranges."[287] However, in light of the opinions in *Chamber of Commerce* and *Business Roundtable*, providing a range or estimate is not just an option, but a mandate.[288] Only when quantification is *impossible* are the Commissions relieved of such estimation; yet, even in such

[283] OFFICE OF THE INSPECTOR GENERAL, *supra* note 236, at 36.
[284] *Id.*
[285] *Id.*
[286] *See generally* Bus. Roundtable v. SEC, 647 F.3d 1144, 1150 (D.C. Cir. 2011); *see also* Pub. Citizen v. Fed. Motor Carrier Safety Admin., 374 F.3d 1209, 1221 (D.C. Cir. 2004) (holding the agency must make tough choices). It should be noted, too, that a "best guess" would require an explanation of accuracy and reliability as to the potential quantitative impact of a rule.
[287] *See* OFFICE OF THE INSPECTOR GENERAL, *supra* note 236, at 25 (emphasis added).
[288] *See* Bus. Roundtable, 647 F.3d at 1150; Chamber of Commerce v. SEC, 412 F.3d 133, 143 (D.C. Cir. 2005).

circumstances, the Commissions should still provide an explanation as to why such estimates are unavailable.[289]

V. Judicial Review of Cost-Benefit Analysis in Rulemakings

Some in the scholarly community have articulated the view that the D.C. Circuit's decision in *Business Roundtable* implicitly heightened the economic analysis requirement the SEC faces in rulemakings.[290] If this view holds true, then the reach of *Business Roundtable* is not limited to the SEC, but will also affect the legitimacy of cost-benefit analysis in CFTC rulemakings as well.[291]

Faulty cost-benefit analysis exposes the SEC and CFTC to challenges from petitioners primarily on two grounds. First, petitioners can claim that the agency failed to abide by statutorily or voluntarily imposed procedural requirements.[292] Second, petitioners, on substantive grounds, can claim that a final rule is arbitrary and capricious for failing to adequately conduct a cost-benefit analysis.[293] Although the D.C. Circuit invalidated SEC promulgations in three cases—*Chamber of Commerce*, *American Equity*, and *Business Roundtable*—due to fact that these promulgations were arbitrary and capricious on substantive grounds, both procedural and substantive claims are available to challengers. This section will provide an overview of the issues involved in both procedural and substantive challenges and how the courts attempt to address each type of claim on review. Additionally, this section will analyze existing case law and whether the D.C. Circuit has employed consistent and appropriate standards of judicial review.

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[289] *See* Chamber of Commerce, 412 F.3d at 144.
[290] *See generally* David B.H. Martin, *Implications of the Proxy Access Case*, HLS FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Aug. 23, 2011), http://blogs.law.harvard.edu/corpgov/2011/08/23/implications-of-the-proxy-access-case/; Kevin M. LaCroix, *D.C. Circuit Vacates Proxy Access Rules, Blasts the SEC*, THE D&O DIARY (July 25, 2011), http://www.dandodiary.com/tags/proxy-access/.
[291] *See generally* Martin, *supra* note 288.
[292] *See generally* Vt. Yankee Nuclear Power Corp. v. Natural Res. Def. Council, Inc., 435 U.S. 519 (1978).
[293] *See generally* Motor Vehicle Mfr. Ass'n. v. State Farm Mutual Auto. Ins. Co., 463 U.S. 29 (1983).

A. Cost-Benefit Analysis as Procedural Requirement

Section 553 of the APA generally provides the maximum procedural requirements agencies face in rulemakings.[294] However, in addition to section 553, agencies must abide by the procedures mandated by other statutes (such as the Regulatory Flexibility Act, Paperwork Reduction Act, *etc.*), their own organic statutes, and any self-imposed procedural rules enacted by agencies.[295] For example, one of the additional procedures that both the SEC and CFTC face is the cost-benefit analysis requirement present in both agencies' organic statutes.[296] To ensure agencies comply with their statutorily mandated procedural requirements, section 706(2)(D) of the APA authorizes a reviewing court "to hold unlawful and set aside agency action, findings, and conclusions found to be—without observance of procedure required by law."[297]

In the late 1970s, in *Kleppe v. Sierra Club*, the Supreme Court was concerned that judicial creation of *ex ante* procedural requirements during "hard look" review would lead to agency uncertainty in the interpretation of statutory requirements.[298] Two years later, in an effort to alleviate these concerns, the Supreme Court issued a landmark opinion in *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council Inc.* that precluded the judiciary from imposing new procedural requirements on agency rulemakings beyond those imposed by statute or the Constitution.[299]

In *Vermont Yankee*, the Court had consolidated two cases from the D.C. Circuit challenging rulemakings before the United States Atomic Energy Commission.[300] The primary issue before the Court was whether the D.C. Circuit had "engraft[ed] [its] own notions of proper procedures upon [an agency] entrusted with

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[294] *See* Vt. Yankee, 435 U.S. at 524 (relying on U.S. v. Allegheny-Ludlum Steel Corp, 406 U.S. 742 (1972) and U.S. v. Fla. E. Coast R. Co., 410 U.S. 224 (1973)).
[295] *See generally id.* at 524 (holding, *inter alia*, that, apart from the APA's procedural requirements, Congress has allowed the agencies to impose additional procedural safeguards).
[296] *See generally* Mark Seidenfeld, *A Table of Requirements for Federal Administrative Rulemaking*, 27 FLA. ST. U.L. REV. 533, 535–37 (2000).
[297] 5 U.S.C. § 706(2)(D) (2006).
[298] 427 U.S. 390, 406.
[299] Vt. Yankee, 435 U.S. at 541; *see* Jack M. Beerman & Gary Lawson, *Reprocessing Vermont Yankee*, 75 GEO. WASH. L. REV. 856, 858 (2007).
[300] *Vt. Yankee*, 435 U.S. at 525.

substantive functions by Congress" when it determined that the rulemaking procedures employed by the Atomic Energy Commission were not adequate.[301] The D.C. Circuit concluded that the records available for review were not sufficient to sustain the rulemakings.[302] Without prescribing specific alternative procedures for the agency to follow, the D.C. Circuit, in one of the cases, identified the numerous procedures available to the agency, explaining:

> We do not presume to intrude on the agency's province by dictating to it which, if any, of these devices it must adopt to flesh out the record. It may be that no combination of the procedures mentioned above will prove adequate, and the agency will be required to develop new procedures to accomplish the innovative task of implementing NEPA through rulemaking. On the other hand, the procedures the agency adopted in this case, if administered in a more sensitive, deliberate manner, might suffice. Whatever techniques the Commission adopts, before it promulgates a rule limiting further consideration of waste disposal and reprocessing issues, it must in one way or another generate a record in which the factual issues are fully developed.[303]

However, the Supreme Court reversed the D.C. Circuit, explaining that "[a]bsent constitutional constraints or extremely compelling circumstances, the 'administrative agencies should be free to fashion their own rules of procedure and to pursue methods of inquiry capable of permitting them to discharge their multitudinous duties.'"[304] The Court held that "[a]dministrative decisions should be set aside in this context . . . only for substantial procedural or substantive reasons as mandated by statute [and] not simply because the court is unhappy with the result reached."[305]

Many view the decision in *Vermont Yankee* to stand as a hard and fast rule prohibiting the judiciary from imposing additional

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[301] *Id.*
[302] *Id*. at 544–45.
[303] Natural Res. Def. Council v. U.S. Nuclear Regulatory Comm'n, 547 F.2d 633, 653–54 (D.C. Cir. 1976).
[304] *Vt. Yankee*, 435 U.S. at 543.
[305] *Id*. at 558

procedures on agency rulemakings that are not mandated by statute or voluntarily undertaken by the agency.[306] The apparent severity of the limitation that this decision apparently places on the judiciary, however, has been short-lived in the substantive review context because of other decisions permitting a more searching and less deferential review of agency rulemakings.[307] For example, the judicial doctrine of "hard-look" substantive review—which will be discussed in greater detail in the next section—has left many scholars thoroughly disappointed with the direction the courts have pursued when determining the scope of substantive judicial review.[308] While it is beyond the scope of this paper to discuss the merits of the general scope of judicial review, in the context of the judicial review of agency cost-benefit analysis, courts should reflect on the spirit of *Vermont Yankee* and the language contained in dicta, explaining why courts are restricted from imposing additional procedural requirements on agencies engaged in rulemakings.

As described above, the Supreme Court rebuked the D.C. Circuit for ruling that an agency's rulemakings were inadequate because the agency did not utilize additional procedures to better develop the record.[309] The Court appeared to suggest two primary reasons for broadening the scope of judicial review of agency procedures. First, the Court briefly noted that the D.C. Circuit had no *statutory* authority to order the Atomic Energy Commission to facilitate the generation of a new key report that announced the generic safety concerns in layman's terms.[310] The Supreme Court appeared to solidify its reversal of the D.C. Circuit's holding in the notion that the lack of any language permitting the judiciary to impose such a requirement or procedure prevents the court from imposing such a mandate. This is meaningful in the cost-benefit

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[306] *See* Beerman & Lawson, *supra* note 297, at 858.

[307] *Id.* (explaining that many scholars have been awaiting a "Vermont Yankee II" "to put an end to rigorous substantive judicial review of agency policy decisions" which some scholars believe "raise essentially the same problems of law and policy as did the procedural doctrines rejected by the Court in Vermont Yankee").

[308] *Id*. at 881–82 (citing Professor Paul R. Verkuil who "expressed disappointment that the Supreme Court had not used Vermont Yankee as a vehicle to clarify the appropriate scope of judicial review").

[309] *Vt. Yankee*, 435 U.S. at 557.

[310] *Id.* (holding that the D.C. Circuit's decision to order the Commission "to give a short explanation . . . of each generic safety concern" was unsupportable).

context of the SEC and CFTC because both agencies' organic statutes do not contain definite language elaborating on the precise approach each agency should employ to satisfy its cost-benefit requirement.

While the CFTC's provision provides a somewhat more in-depth collection of interests for consideration in the cost-benefit inquiry, it does not enumerate exactly how the CFTC can fulfill its requirement.[311] The SEC's statute provides an even broader inquiry, requiring only the consideration of whether the action will promote "efficiency, competition and capital formation."[312] Additionally, the legislative histories of both agencies' provisions are devoid of any *exact* process. From a procedural perspective, the equivocality of both provisions makes it unclear what the complete procedural requirements of an adequate cost-benefit analysis require. Thus, to the extent the D.C. Circuit is simply interpreting the requirements of both the SEC and CFTC's cost-benefit analysis provisions, and not imposing *new* procedural requirements, its holding would comport with the judicial limitations imposed by *Vermont Yankee*. However, because cost-benefit analysis is not a simple procedural requirement such as, say, cross-examination—like the one at issue in *Vermont Yankee*—it is nearly impossible to determine whether a court holding an agency rulemaking to a higher procedural requirement is violating *Vermont Yankee*, as opposed to merely holding the agency responsible for fulfilling its substantive statutory duty under each agency's respective cost-benefit analysis provisions.

The second reason for which the Court broadened the scope of judicial review of agency procedures was the Court's desire to emphasize that the practical state of agencies is one of limited time and resources.[313] Devoting significant attention to explaining that procedures exist to ensure and encourage public participation in rulemakings, the Court urged that common sense must dictate the degree of detailed discussion an agency must engage in when determining which comments deserve responses and in which manner to respond.[314] This acknowledgment of limited agency resources surrounded the Court's discussion in *Vermont Yankee* of

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[311] *See* 7 U.S.C. § 19(a) (2006).
[312] 15 U.S.C. § 78c(f) (2006).
[313] *Vt. Yankee*, 435 U.S. at 551.
[314] *Id.*

how to determine whether an environmental impact statement was adequate.[315]

Practically speaking, an environmental impact statement is extremely similar to a procedural cost-benefit analysis.[316] A procedural cost-benefit analysis statute is one where an agency is not required to balance the costs and benefits of alternatives, but instead *only* requires an agency to perform the *act* of balancing.[317] An environmental impact statement seeks to provide a justification for taking a certain action and includes a detailed assessment of the effects of that action and any other alternatives that could also achieve the desired outcome; thus, it operates as a procedural cost-benefit statute.[318] To the extent the cost-benefit analysis provisions of the SEC and CFTC's organic statutes are considered procedural, the Supreme Court's admonition of limited agency resources *should* inform the judiciary's review of the SEC and CFTC's cost-benefit analysis. However, to the extent the cost-benefit analysis provisions of the SEC and CFTC's organic statutes are considered *substantive*, courts are likely permitted to engage in a more careful consideration and analysis of the steps taken by the agencies. This latter interpretation is likely the route the D.C. Circuit pursued in deciding *Chamber of Commerce*, *American Equity*, and *Business Roundtable*.

B. Cost-Benefit Analysis as Substantive Requirement

In the only cases decided on the issue of the adequacy of a cost-benefit analysis in an SEC or CFTC rulemaking, challengers successfully argued that each final rule was arbitrary and capricious for failing to adequately consider the costs and benefits of the

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[315] *Id.*
[316] *See* Jason Scott Johnston, *A Game Theoretic Analysis of Alternative Institutions for Regulatory Cost-Benefit Analysis*, 150 U. PA. L. REV. 1343, 1352 (2002).
[317] *Id.*
[318] *Id.*; *see also* George H. Keller, *Greenpeace USA v. Stone: The Comprehensive Environmental Impact Statement and the Extraterritorial Reach of NEPA*, 14 U. HAW. L. REV. 751, 762–63 (1992) (stating that an environmental impact statement "must discuss the environmental impact of the action, any unavoidable adverse effects of the action, and any alternatives to the action").

promulgated rule.[319] Section 706(2)(A) of the APA allows a reviewing court to "hold unlawful and set aside agency action, findings, and conclusions found to be—arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[320] Although the interpretation of this provision has changed over time, the Supreme Court iterated the current standard in *Motor Vehicle Manufacturing Ass'n v. State Farm Mutual Auto. Ins. Co.* ("*State Farm*").[321]

> Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could be ascribed to a difference in view or the product of expertise.[322]

This standard authorizes judges to perform a "searching and careful review of the substance of an agency decision" to ensure that the agency took a "hard look" at all of the available options and strike down agency actions insufficiently explained.[323] It is unclear to what extent this explanation permits a reviewing judge to scrutinize an agency's explanation for taking a specific action.[324] At the very least, the interaction of the standards articulated in *Vermont Yankee* and *State Farm*, have led to agency uncertainty in how to proceed

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[319] *See* Chamber of Commerce v. SEC, 412 F.3d 133, 136 (D.C. Cir. 2005) (holding that the SEC violated the APA by failing to adequately consider the costs and benefits of the requirements for an independent directors and an independent chairman); *see also* Bus. Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (holding the SEC acted "arbitrarily and capriciously" in assessing the economic effects of its rules); Am. Equity Inv. Life. Ins. Co. v . SEC, 614 F.3d 166, 177–78 (D.C. Cir. 2009) (holding that the SEC must adopt a rule that "provides greater clarity to an area that remained unclear in the absence of any rule").

[320] 5 U.S.C. § 706(2)(A) (2012).

[321] 463 U.S. 29, 43 (1983); *see* Patrick M. Garry, *Judicial Review and the "Hard Look" Doctrine*, 7 NEV. L.J. 151, 151 (2006).

[322] *State Farm*, 463 U.S. at 43.

[323] Toby Coleman, *Limiting Judges: Placing Limits on Judges' Power in Hard-look Review*, 88 U. DET. MERCY L. REV. 883, 891 (2011).

[324] *Id.* at 891–92.

with rulemakings because *State Farm* appears to necessitate the employment of additional procedures in order to provide more robust support for rulemakings, which *Vermont Yankee* explicitly prohibits the judiciary from imposing.[325] However, the Supreme Court's requirement in *State Farm* that an agency "articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made,"[326] as well as consider "all relevant factors" and consider any "alternative ways of achieving" its objectives,[327] clearly diverges from an earlier judicial standard—the minimum rationality test, which required an agency to "merely consider the facts and explain its decision."[328]

Regardless of the practical workability of the standard articulated in *State Farm*, it is the standard that the D.C. Circuit relies on when reviewing agency cost-benefit analysis. For example, in *Chamber of Commerce* the Court, quoting *State Farm*, stated:

> Although the "scope of review under the 'arbitrary and capricious' standard is narrow and a court is not to substitute its judgment for that of the agency," we must nonetheless be sure the Commission has "examined the relevant data and articulated a satisfactory explanation for its action including a rational connection between the facts found and the choice made."[329]

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[325] Garry, *supra* note 319, at 160. The decisions of Vermont Yankee and State Farm are contradictory, with State Farm seemingly overruling Vermont Yankee leading to agency uncertainty and "might indirectly force agencies to employ the sort of additional procedures that Vermont Yankee prohibits the judiciary from imposing directly." *Id.*

[326] *State Farm*, 463 U.S. at 43. The standard of review of agency rulemaking is based on the "arbitrary and capricious standard" which is narrow. However, the Supreme Court held in State Farm that "the agency must examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made.'" *Id.*

[327] *Id*. at 48.

[328] Garry, *supra* note 319, at 156 (quoting Merrick B. Garland, *Deregulation and Judicial Review*, 98 HARV. L. REV. 505, 525 (1985) ("'The hard look' standard was also quasi-procedural, encompassing 'a set of requirements intended to ensure that the agency itself had taken a hard look at the relevant issues before reaching its decision.'")).

[329] Chamber of Commerce v. SEC, 412 F.3d 133, 140 (D.C. Cir. 2005).

Because of the unpredictability of the practical application of this "hard-look" standard, many agencies are left with only the "political and ideological beliefs" of the judges who apply the test.[330] Therefore, judges can effectively use the authorization permitted in *State Farm* for "searching and careful"[331] review of agency rulemakings, as a conduit for their own personal beliefs as to the legitimacy and necessity of a final rule.[332] Thus, this arguably broad authority to review the sufficiency of an explanation for a final rule permits the D.C. Circuit to conduct a searching and careful analysis of the cost-benefit analysis employed in SEC and CFTC rulemakings.

C. Analyzing *Business Roundtable* and Its Predecessors

Cost-benefit analysis' subjection to a "searching" judicial review provides the judiciary with an additional avenue to vacate a final rule. To the extent a reviewing judge determines that an agency's cost-benefit analysis does not comport with the broad standard articulated in *State Farm*, the final rule can be struck down as arbitrary and capricious for failing to adequately consider costs and benefits.[333] This subsection largely analyzes the D.C. Circuit's decision in *Business Roundtable* with its two previously decided cases regarding the adequacy of cost-benefit analysis. Because of the broad latitude that *State Farm* provides the D.C. Circuit to strike down a final rule as arbitrary and capricious, especially for failing to

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[330] *See* RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW 85 (Foundation Press 2007) (relying on Richard Revesz, *Environmental Regulation, Ideology, and the D.C. Circuit*, 83 VA. L. REV. 1717, 1721 (1997)) (stating that courts apply the State Farm test based on their political and ideological beliefs); *see also* Scott A. Keller, *Depoliticizing Judicial Review of Agency Rulemaking*, 84 WASH. L. REV. 419, 422 (2009) ("[A]dministrative law doctrines for judicial review of agency rulemaking have become a 'judicially created obstacle course' that gives judges far too much leeway to reach results based on their partisan policy preferences.").

[331] Coleman, *supra* note 321, at 892.

[332] *See generally* Keller, *supra* note 328, at 423 ("It would be a mistake; however, for judges to continue using indeterminate administrative law doctrines to invalidate agency rules on the basis that they disagree with the policy decisions of a presidential administration.").

[333] *See* Moto Vehicle Mfn. Ass'n v. State Farm Mutual Auto. Ins. Co., 463 U.S. 29, 41 (1983).

"consider an important aspect of the problem," as well as for failing to establish a "rational connection between the facts found and the choice made," it is difficult to find fault in the D.C. Circuit's holding in *Business Roundtable*.[334]

Generally, the holding in *Business Roundtable* comports with the D.C. Circuit's holdings in both *Chamber of Commerce* and *American Equity* because the SEC again failed to adequately quantify certain costs.[335] Analogous to the court's other holdings, *Business Roundtable* interpreted section 3(f) to require the SEC to provide economically quantifiable data even if such data is a best estimate within a range of reasonable possibility.[336] In *Business Roundtable*, the court determined that the SEC failed to "adequately . . . quantify the certain costs or to explain why these costs could not be quantified."[337] Similar to *Chamber of Commerce*, the SEC failed to reasonably explain the lack of quantification of certain costs, and similar to *American Equity Investments*, the SEC failed to establish baseline economic data on which to support Rule 14a-11's compliance with section 3(f). Therefore, *Business Roundtable* appears to be a combination of the D.C. Circuit's holdings in *Chamber of Commerce* and *American Equity Investments*.

While *Business Roundtable* comports with these prior decisions to a certain degree, an inconsistency is found in the D.C. Circuit's treatment of empirical analysis. The *Business Roundtable* court attacked the SEC's invalidation of certain empirical studies.[338] When an agency is faced with mixed empirical data in a rulemaking, the D.C. Circuit has traditionally given deference to the choices that the agency makes so long as the decisions are adequately explained.[339] In finalizing Rule 14a-11, the SEC conformed with Supreme Court jurisprudence by referring to studies and data on

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[334] Bus. Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C. Cir. 2011).
[335] *Id.* at 1148 (citing *Chamber of Commerce* and *American Equity* in holding that the SEC acted arbitrarily by failing "to adequately assess the economic effects of a new rule").
[336] *See id.* (citing Chamber of Commerce, 412 F.3d at 143).
[337] *Id.* at 1149.
[338] *See id.* at 1150.
[339] *See Chamber of Commerce*, 412 F.3d at 143 (citing Hüls Am. Inc. v. Browner, 83 F.3d 445, 452 (D.C. Cir. 1996), which states that a court owes "extreme degree of deference" when an agency "evaluate[s] scientific data within its technical expertise"); *see also* Moto Vehicle Mfn. Ass'n v. State Farm Mutual Auto. Ins. Co., 463 U.S. 29, 45 (1983).

which it relied.[340] In addition, when agencies are presented with quality studies from credible consultants during the notice and comment period, they must adequately respond to the studies presented.[341] Therefore, the question is whether the D.C. Circuit incorrectly determined that the SEC inadequately addressed highly qualified mixed empirical evidence presented during the comment period for Rule 14a-11.

Under *Chamber of Commerce*, the D.C. Circuit deferred to the SEC in discrediting submitted studies.[342] The court concluded that the SEC determined that the study was "'unpersuasive' because . . . it [had] not rule[d] out 'other important differences . . . that may have impacted performance results . . . and because it did not use a reliable method of calculating" the relevant issue.[343] Thus, the D.C. Circuit held that "although a more detailed discussion of the study might have been useful, the [SEC] made clear enough the limitations of the study," and that it had "no cause to disturb [the SEC's] *ultimate judgment*" regarding the persuasiveness of the study.[344]

A plausible argument is that the D.C. Circuit did not follow *Hüls America Inc. v. Browner*, on which it relied in *Chambers of Commerce*, and failed to grant the SEC an "extreme degree of

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[340] *See* Portland Cement Ass'n v. Ruckelshaus, 486 F.2d 375, 402 (D.C. Cir. 1999), *superseded on other grounds by* Clean Air Act, 15 U.S.C. § 793(c)(1) (1974) (finding that proper agency review requires an Administrator to base his findings "on extrapolations from [] data, on a reasoned basis responsive to comments, and on testimony from experts and vendors made part of the record").

[341] *See* National Tire Dealers & Retreaders Ass'n v. Brinegar, 491 F.2d 31, 40–41 (D.C. Cir. 1974) (explaining that an agency may not turn a "blind eye" to credible evidence presented to it). The court stated: "While it is true that an agency may act after informal rule-making procedures 'upon the basis of information available in its own files, and upon the knowledge and expertise of the agency, in the case at bar the Secretary's allusions to information and knowledge outside the record are unpersuasive in light of the powerful doubts raised by the on-the-record comments of petitioner and others about the practicability of the permanent labeling requirements. The Secretary's statement of the reasons for his conclusion that the requirements are practicable is not so inherently plausible that the court can accept it on the agency's mere *ipse dixit*." *Id.*

[342] *See Chamber of Commerce*, 412 F.3d at 142–43.

[343] *Id.* at 143.

[344] *Id.* (emphasis added) (citing *Hüls*, 83 F.3d at 452, which states that a court owes "extreme degree of deference" when an agency "evaluate[s] scientific data within its technical expertise").

deference" regarding its review of the empirical studies submitted in *Business Roundtable*. The D.C. Circuit acknowledged that the SEC discounted studies that ran counter to their conclusion "because of questions raised by subsequent studies, limitations acknowledged by the studies' authors, or [its] own concerns about the studies' methodology or scope."[345] In *Chamber of Commerce*, the D.C. Circuit allowed the SEC to reject a study because, in the SEC's view, it did not employ a reasonable method,[346] yet in invalidating Rule 14a-11, the court questioned the SEC's rejection of certain empirical studies due to their methodology or scope.[347]

Perhaps the D.C. Circuit's contradictory treatment of empirical studies is attributable to the studies that were chosen and not simply the rejection of unreliable studies. In *Business Roundtable*, the court ultimately qualified its chastisement of the SEC not for the rejection of certain submitted studies, but for the SEC's choice to rely on certain studies over others.[348] Thus, instead of reviewing the SEC's rejection of a study due to qualified limitations under an "extreme degree of deference," the D.C. Circuit reviewed the SEC's choice between studies of "mixed empirical evidence" under a lower deferential standard.[349] Therefore, as *Browner* deference was not applied in either *Business Roundtable* or *American Equity Investments* to the SEC's review of those studies submitted, the status of the D.C. Circuit's application of such deference is currently unknown and may not be applied until re-established.

Despite the few internal inconsistencies among these three cases, the issues to which they pertain go to the question of whether the SEC sufficiently explained its final rule. Because there is no clear process or methodology for conducting a cost-benefit analysis, as well as no clear standard for reviewing the adequacy of a cost-benefit analysis, the D.C. Circuit's decisions are likely permissible given the current state of administrative law.

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[345] *Business Roundtable*, 647 F.3d at 1151 (quoting SEC Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668, 56,762–63 (Sept. 16, 2010).

[346] *See Chamber of Commerce*, 412 F.3d at 143.

[347] *See Business Roundtable*, 647 F.3d at 1151.

[348] *See id.*

[349] *Id.* (holding that SEC, in view of "admittedly (and at best) 'mixed' empirical evidence . . . [did] not sufficiently support[] its conclusion . . . .").

VI. Proposed Solutions

The tremendous uncertainty surrounding the requirements of sections 3(f) and 15(a) will continue to undermine the rules promulgated by the SEC and CFTC under Dodd-Frank. Further action needs to be taken by the agencies themselves, Congress, or the judiciary, explaining more precisely the requirements of agency cost-benefit analysis. This section proposes five potential steps that can bring more certainty to the process.

A. Adopt Elements of the EPA's Guidelines for Cost-Benefit Analysis

The Environmental Protection Agency ("EPA") has perhaps the most perplexing and complicated economic analysis requirements in promulgating rules and regulations. In many respects, the EPA is revered, but also heavily criticized, for being the model agency for conducting economic analyses when instituting new rules and regulations.[350] Its stringent requirements largely stem from the widespread concern of the impact that environmental regulations will have on the economy.[351] Consequently, it is only logical that any rules and regulations promulgated by the agency be subject to immense scrutiny and close examination.[352] This section

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[350] *See generally* JAMES E. MCCARTHY & CLAUDIA COPELAND, CONG. RESEARCH SERV., R41561, EPA REGULATIONS: TOO MUCH, TOO LITTLE, OR ON TRACK? (2012).

[351] NATIONAL CENTER FOR ENVIRONMENTAL ECONOMICS, U.S. ENVIRONMENTAL PROTECTION AGENCY, GUIDELINES FOR PREPARING ECONOMIC ANALYSES 1-1 to 1-2 (Dec. 17, 2010), *available at* http://yosemite.epa.gov/ee/epa/eerm.nsf/vwAN/EE-0568-50.pdf/$file/EE-0568-50.pdf [hereinafter "Guidelines"]. Additionally, while some critics argue that cost-benefit analysis is a neutral tool that is essential in assessing the impact and value of a potential rulemaking, some are critical that cost-benefit analysis favors industry and disfavors health, safety, and environmental protection. *See* David M. Driesen, *Is Cost-Benefit Analysis Neutral?*, 77 U. COLO. L. REV. 335, 335–38 (2006).

[352] *See generally* Nicolas Loris, *The Economic Effects of Environmental Regulations*, THE FOUNDRY BLOG (Jan. 30, 2009, 5:00 PM), http://blog.heritage.org/2009/01/30/the-economic-effects-of-environmental-regulations/; Joseph F.C. DiMento & Helen Ingram, *Science and Environmental Decision Making: The Potential Role of Environmental*

will look first at the history of the EPA and the type of cost-benefit analysis Congress requires it to conduct. Next, this section analyzes the *Guidelines for Preparing Economic Analyses* ("*Guidelines*") that the EPA utilizes when conducting an analysis of the costs and benefits of a potential regulation. Because the *Guidelines* runs nearly 300 pages and provides a detailed and complex assessment of cost-benefit analysis, this section will particularly focus on the *Guidelines'* recommendations for establishing a baseline and presenting economic analysis in rulemakings. Finally, the viability of using such detailed and complex requirements in the financial regulatory context is explored.

1. Creation of the EPA and the History of the Agency's Cost-Benefit Analysis Requirements

In 1970, the Nixon administration was increasingly concerned about the condition of the environment and the fragmented regulatory approach that was used to address pollution and other environmental problems.[353] On July 9, 1970, President Richard Nixon presented Reorganization Plan Number Three to Congress.[354] This plan aimed to "rationally and systematically" organize a piecemeal environmental regulatory structure into a single autonomous agency: the EPA.[355] Congressional hearings occurred without any serious opposition to the creation of the new agency, and

Impact Assessment in the Pursuit of Appropriate Information, 45 NAT. RESOURCES J. 283, 285–86 (2005).

[353] 116 CONG. REC. H23, 528 (daily ed. July 9, 1970) (message from President Richard Nixon to Congress) ("As concern with the condition of our physical environment has intensified, it has become increasingly clear that we need to know more about the total environment . . . . The Government's environmentally-related activities have grown up piecemeal over the years. The time has come to organize them rationally and systematically.").

[354] *Id*. at 23,529.

[355] *Id.* at 23,528. Prior to creating the EPA, several different government agencies performed various environmental regulatory roles. These agencies include the Federal Water Quality Administration, the Department of the Interior, the National Air Pollution Control Administration, the Bureau of Solid Waste Management and the Bureau of Water Hygiene, the Bureau of Radiological Health of the Environmental Control Administration, the Food and Drug Administration, and the Agricultural Research Service. *Id*.

Congress officially established it on December 2, 1970.[356] Specifically, Congress tasked the EPA with "establish[ing] and enforc[ing] . . . environmental protection standards," "gathering . . . information on pollution," developing "environmental protection programs," recommending policy changes, and issuing grants and providing technical assistance to decrease human impact on the environment.[357]

In 1990, Congress passed amendments to the Clean Air Act.[358] Section 812 of the amendments changed section 312 of the Clean Air Act, which requires the EPA to engage in an analysis of the rule's economic impact.[359] Specifically, the amendment requires the EPA Administrator,[360] along with the Secretary of Commerce, the Secretary of Labor, and the Council on Clean Air Compliance Analysis, to "conduct a comprehensive analysis of the impact of this [Act] on the public health, economy, and environment of the United States."[361] In performing the analysis, "the Administrator should consider the costs, benefits and other effects associated with compliance with each standard issued.[362] The statute also imposes a meticulous process upon the Administrator when analyzing and

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[356] *See* ENVIRONMENTAL PROTECTION AGENCY, THE GUARDIAN: ORIGINS OF THE EPA (1992), *available at* http://www.epa.gov/aboutepa/history/publications/print/origins.html (last visited Sept. 11, 2012).

[357] *Id.*

[358] Clean Air Act Amendments of 1990, Pub. L. No. 101-549, 104 Stat. 2399, 2399. While the EPA is tasked with implementing and overseeing several statutes, the Clean Air Act cost-benefit analysis requirement is an example of the statutory responsibility of the EPA when promulgating rules and regulations.

[359] *Id.* sec. 812, § 312, 104 Stat. at 2691 (codified at 42 U.S.C. § 7612 (1990)) .

[360] The EPA Administrator is the head of the agency. Ben Geman, *EPA Nominee Would Face Uncertain Path*, THE HILL E2 WIRE (Dec. 30, 2012, 7:00 AM), http://www.thehill.com/blogs/ (calling Administrator the "top job" in the EPA). While the EPA is not a Cabinet department, it is typically given Cabinet rank. THE WHITE HOUSE: THE CABINET, http://www.whitehouse.gov/administration/cabinet/ (last visited Mar. 20, 2013) (stating that the EPA has Cabinet rank). The Administrator is nominated by the President and confirmed by the Senate much like other Cabinet level individuals. *See* Geman (explaining likely obstacles in the appointment process for the next EPA Administrator nominee).

[361] Clean Air Act § 312(a).

[362] *Id.*

considering the benefits of a standard.[363] Additionally, the Administrator must describe the costs that new standards might impose on the economy in general.[364] What has followed from this statutory requirement is one of the most robust and involved cost-benefit analyses that any federal regulatory agency conducts.[365] The following section discusses the guidelines the EPA uses when conducting these analyses.

2. Specific EPA Guidelines for Preparing Economic Analyses an Multifaceted Approach

In December 2010, the EPA implemented its *Guidelines for Preparing Economic Analyses*.[366] The *Guidelines* resulted from collaboration between the EPA's National Center for Environmental Economics ("NCEE") and numerous economists throughout the agency.[367] The current version of the *Guidelines* is a compilation of work from previous guidelines, Executive Orders, and other various guidance documents.[368] Furthermore, the *Guidelines*' design allows for the inclusion of new developments and information for

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[363] *Id.* § 312(b) ("In describing the benefits of a standard . . . , the Administrator shall consider all of the economic, public health, and environmental benefits of efforts to comply with such standard. In any case where numerical values are assigned to such benefits, a default assumption of zero value shall not be assigned to such benefits unless supported by specific data. The Administrator shall assess how benefits are measured in order to assure that damage to human health and the environment is more accurately measured and taken into account.").

[364] *Id.* § 312(c) ("[I]n describing the costs of a standard . . . , the Administrator shall consider the effects of such standard on employment, productivity, cost of living, economic growth, and the overall economy of the United States.").

[365] *See generally* FRANK ACKERMAN, ET AL., APPLYING COST-BENEFIT ANALYSIS TO PAST DECISIONS: WAS PROTECTING THE ENVIRONMENT EVER A GOOD IDEA? (July 2004), *available at* http://www.ase.tufts.edu/gdae/Pubs/rp/CPRRetrospectiveCBAJuly04.pdf.

[366] *See Guidelines for Preparing Economic Analyses*, NATIONAL CENTER FOR ENVIRONMENTAL ECONOMICS, http://yosemite.epa.gov/ee/epa/eed.nsf/pages/guidelines.html#howproduced (last visited Sept. 11, 2012).

[367] *Id.*

[368] *Id.* at 1-1.

conducting economic analysis in the future.[369]

Although the *Guidelines* provides a framework to assist analysts when preparing economic analyses of environmental policies, it is not a "rigid blueprint or a 'cookbook' for all policy assessments," but instead a "summary of analytical methodologies, empirical techniques, and data sources that can assist in performing economic analysis of environmental policies.[370] The most beneficial aspect of the *Guidelines* is its identification of the baseline against which the effect of regulation can be measured and the presentation of the analysis in the adopting release.

The *Guidelines* spills a considerable amount of ink enunciating the importance of establishing a baseline that provides a "clear point of comparison with the policy scenario and allows for an unequivocal measure of the benefits, costs, and other consequences of the rule."[371] A persistent point of criticism that the courts have had with the SEC's cost-benefit analysis is its failure to identify the proper baseline.[372] In contrast, the *Guidelines* defines the appropriate cost-benefit baseline as "the best assessment of the world absent the proposed regulation or policy action."[373] In particular, EPA analysts are advised to follow eight guidelines when specifying the baseline of a potential regulation:

> (1) Clearly specify the current and future state of relevant economic variables, the environmental problem that the regulation addresses and the regulatory approach being considered; (2) Identify all required parameters for the analysis; (3) Determine the appropriate level of effort for baseline specification; (4) Clearly identify all assumptions made in specifying the baselines conditions; (5) Specify the

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[369] *Id.* In a sense, the *Guidelines* is an evolving tool that will continue to develop as new analytical tools and approaches are developed without requiring a complete overhaul or revision of the entire document. *Id.*
[370] *Id*. at 1-2.
[371] *Id.* at 5-2.
[372] *See, e.g.*, Am. Equity Inv. Life Ins. Co. v. SEC, 613 F.3d 166, 178 (D.C. Cir. 2010) (holding that "[t]he SEC could not accurately assess any potential increase or decrease in competition . . . because it did not assess the baseline level of price transparency and information disclosure under state law").
[373] *Guidelines*, *supra* note 364, at 5-1.

> "starting point" of the baseline and policy scenario; (6) Specify the "ending point" of the baseline and policy scenario; (7) Detail all aspects of the baseline specification that are uncertain; and (8) Use the baseline assumptions consistently for all analyses for this regulation.[374]

A large part of identifying the baseline revolves around not only identifying what the EPA knows about how the world works absent the regulation but also understanding what it does not know.[375] Most of the advice contained in the *Guidelines* pertains to clearly identifying the problem, the regulation that proposes to solve or alleviate this problem, and how the regulation will exactly go about accomplishing this feat.[376]

However, the *Guidelines* also requires analysts to account for everything that goes into their analysis and also what does not. It provides that analysts should explain whether variables used in their analysis are "modeled or set by fixed assumptions."[377] Additionally, analysts should also note in detail what "information . . . was not included is their analysis due to scientific uncertainty."[378] Finally, analysts are instructed to "use the baseline assumptions consistently [throughout their] analyses."[379] Failure to consistently use baseline assumptions throughout the analyses is another problem SEC cost-benefit analyses have had in withstanding judicial scrutiny.[380] Specifically, defects in the baseline were one of the focuses of the D.C. Circuit in *Business Roundtable* where the court held that the SEC was inconsistent when it discounted the costs of the proposed rule, but not the benefits.[381] Furthermore, the *Guidelines* specifies that if it becomes necessary for an analyst to devise more than one baseline, he should do so with extreme caution and explicitly account

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[374] *Id.* at 5-2.
[375] *See id*.
[376] *See id.* at 5-3 to 5-6.
[377] *Id.* at 5-3.
[378] *Id.* at 5-5.
[379] *Id.*
[380] *See Business Roundtable*, 647 F.3d at 1151.
[381] *See id.*; *see also Am. Equity Inv. Life Ins. Co.*, 613 F.3d at 178 (finding that "[t]he SEC could not accurately assess any potential increase or decrease in competition . . . because it did not assess the baseline level of price transparency and information disclosure under state law.").

for all differences or uncertainties between the multiple baselines.[382]

Similar to identifying the baseline, appropriately presenting the results of the economic analysis is essential in EPA rulemakings.[383] The *Guidelines* provides several templates for the EPA to utilize when presenting information on the putative costs and benefits of a regulation.[384] Not only should analysts clearly state the "conclusions of the economic analysis," but they should also explain "[h]ow [they] were estimated; [w]hat the important non-quantifi[able] . . . effects [might be]; key assumptions [of] the analysis; [p]rimary sources of uncertainty; and [h]ow the sources of uncertainty might affect the [projected] results."[385] Analysts are instructed to clearly indicate the correspondence between the benefit and cost estimates of their analysis.[386] This is another common problem that the SEC has had with cost-benefit analyses where the identified costs and benefits are not connected to each other.[387] For example, in *Business Roundtable*, one of the reasons the court provided for striking down the SEC rule was that the Commission "discounted the costs of Rule 14a-11 but not the benefits."[388]

Clearly, cost-benefit analysis serves a much more essential role in the EPA's promulgation of rules than it does in other agency rulemakings.[389] The EPA has a very involved and thorough statutory mandate for conducting a cost-benefit analysis. Moreover, it has gone to great lengths to devise a comprehensive and thorough guidance for analysts when conducting economic analyses for rulemakings. While, only a few aspects of the EPA *Guidelines* are discussed in this section, the guidance provided to analysts is extremely complicated and involved.

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[382] *Guidelines*, *supra* note 364, at 5–6.
[383] *Id.* at 11-1.
[384] *Id.* at 11-3.
[385] *Id.* at 11-1.
[386] *Id.* at 11-3.
[387] *See Business Roundtable*, 647 F.3d at 1151 (finding that the SEC discounted the costs but did not also discount the benefits).
[388] *Id.*; *see also Chamber of Commerce*, 412 F.3d at 143 (striking down the rule because the Commission failed to view a cost at the margin).
[389] *See generally* Editorial, *The EPA's Costs and Benefits*, WASH. POST, Sept. 4, 2011, at A16 (arguing that the benefits of EPA regulations – "lives saved, chronic illnesses prevented, hospital visits avoided and sick days not taken"—are as important as the potential costs to business); *cf.* DiMento & Ingram, *supra* note 350, at 285–86 (discussing the complexity of problems facing the EPA when it promulgates rules).

Furthermore, even with its robust procedures and guidance, the EPA has not escaped scrutiny in the courts, where several rules have been struck down for the EPA's failure to perform a complete cost-benefit analysis.[390] An interesting issue left open by the elaborate process that is required by the EPA is whether the complex requirements imposed of such a robust cost-benefit analysis on regulators are too costly for their perceived benefits.[391] It is likely superfluous to apply EPA cost-benefit analysis standards to financial regulatory agencies because while these other agencies must consider varying interests, such interests are often bifurcated between investors and market participants.[392]

B. Preclude Review

The Administrative Procedure Act permits Congress to preclude courts from reviewing legal challenges to specific agency actions.[393] Until the 1960s, agency action was not reviewable unless a statute authorized judicial review or an agency violated a statute, which commanded or prohibited the agency action in such a clear and unambiguous manner.[394] However, by 1967, a presumption of reviewability developed from the enactment of the Declaratory Judgment Act and the landmark Supreme Court holding in *Abbott Laboratories v. Gardner*.[395] Although *Abbott Labs* and the Declaratory Judgment Act generally bestowed the judiciary with the right to review, the power remains limited by APA section 701(a)(1), which precludes judicial review when expressly or implicitly prohibited by Congress.[396]

APA section 701(a)(1) states that the presumption of reviewability "applies, according to the provisions thereof, except to

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[390] *See, e.g.*, Chemical Mfrs. Ass'n v. EPA, 217 F.3d 861, 863, 865–866 (D.C. Cir. 2000) (holding that where EPA claimed "numerous benefits for human health and the environment" and none were found, the EPA "offered an explanation for its decision that runs counter to the evidence before the agency").

[391] *See generally* McCarthy & Copeland*, supra* note 348.

[392] Whereas the EPA musts consider a wider array of interests affected by regulation.

[393] *See* Administrative Procedure Act, 5 U.S.C. § 701(a)(1)-2.

[394] *See* Cynthia Tripi, *Administrative Law: Availability of Judicial Review of Administrative Action*, 55 GEO. WASH. L. REV. 729, 731 (1987).

[395] *See* Abbott Laboratories v. Gardner, 387 U.S. 136, 140–41 (1967).

[396] *See* Administrative Procedure Act § 701(a)(1).

the extent that statutes preclude judicial review."[397] The Supreme Court in *Block v. Community Nutrition Institute*[398] held that review preclusion can be established either expressly or implicitly by Congress.[399] Express preclusion applies if a statute clearly and unequivocally precludes all judicial review of an agency action, thus requiring courts to give the statute the effect prescribed by Congress.[400] Moreover, if the statute does not confer an explicit right of reviewability, or if a group of individuals are expressly given a pattern of rights to review and others are not, courts have held that Congress implicitly precluded review for those who did not receive an express right.[401] Lastly, the *Block* court also stated that "[w]hether and to what extent a particular statute precludes judicial review is determined not only from its express language, but also from the structure of the statutory scheme, its objectives, its legislative history, and the nature of the administrative action involved."[402]

Therefore, a solution that may lead to the greatest probability of upholding SEC and CFTC promulgations under Dodd-Frank would be to expressly preclude judicial review of the promulgation of regulations mandated by Dodd-Frank. Though such preclusion would exclude judicial review of promulgations under the "hard look" doctrine, courts would still be permitted to review issues of constitutionality.[403] While this solution would be easy to achieve, the

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[397] *Id.*; *see also* Tripi, *supra* note 392, at 763 (detailing that implied preclusion may be gleaned from Congressional intent using the traditional tools of statutory construction). For further discussion of a court's power under the use of the traditional tools of statutory construction, see *supra* Part V, sub-section A and accompanying footnotes.
[398] 467 U.S. 340 (1984).
[399] *Id.* at 345; *see also* Association of Data Processing Serv. Orgs. v. Camp, 397 U.S. 150, 156–57 (1970) ("There is no presumption against judicial review and in favor of administrative absolutism, unless that purpose is fairly discernible in the statutory scheme.") (internal citations omitted).
[400] *See Data Processing*, 397 U.S. at 156–57.
[401] *See Block*, 467 U.S. at 349 (holding that a class of individuals may be implicitly precluded from judicial review, but may rebut the presumption of unreviewability by a showing of clear and convincing evidence in five different ways: (1) specific language; (2) specific legislative history; (3) contemporaneous judicial construction barring review; (4) congressional acquiescence in it; and (5) the statutory scheme as a whole).
[402] *Id.* at 345.
[403] *Cf.* Johnson v. Robison, 415 U.S. 361, 366–67 (1974).

probability of Congress taking such an action is remote.[404]

Congress could preclude review in a variety of ways. First, it could preclude review of *any* rules and regulations promulgated by agencies that are statutorily required. This would remove the cost-benefit analysis component from promulgations that Congress manifestly requested in legislation. The only issue courts would then need to decide is whether a rule or regulation was statutorily required.

A second way Congress could preclude review is by precluding review of all rules and regulations under the Dodd-Frank Act. Because Dodd-Frank requires nearly 400 rulemakings, Congress could ease regulatory agencies paths in achieving this goal by insulating a popular route of challenge by those opposed to the new rules and regulations stemming from the Act. However, this route of preclusion could prove tremendously difficult; not only would Congress need to clearly preclude review post-enactment of Dodd-Frank, a feat of political acrobatics, but it would also likely need to preclude judicial review of *all* promulgations under Dodd-Frank to ensure that promulgations by the SEC and CFTC do not escape relevant judicial review.

Furthermore, to preclude review of all promulgations under the Dodd-Frank Act for both the SEC and the CFTC may set a dangerous precedent. If Congress were to preclude review in the current context, why not preclude review for promulgations under the Jumpstart Our Businesses Startups ("JOBS") Act?[405] Also, if

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[404] It is difficult to pass any legislation, including legislation involving regulating the cost-benefit analysis performed by either of these agencies. U.S. Representative Scott Garrett recently tried in June of 2011 to introduce legislation entitled SEC Regulator Accountability Act that was aimed at improving the consideration given to costs and benefits of its regulations by the SEC. *SEC Regulatory Accountability Act (H.R. 1062): Overview*, GOVTRACK, http://www.govtrack.us/congress/bills/112/hr2308#overview (last visited Mar. 21, 2013). Effectively, it would codify cost-benefit analysis (*see* Subsection "c"—"Codify Cost-Benefit Analysis," *infra*). Since March 12, 2013, the bill has been reintroduced—after failing a committee vote—and will be reconsidered in committee. *Id.*

[405] Jumpstart Our Business Startups Act of 2012, Pub. L. No. 112-106, 126 Stat. 306 (to be codified in scattered sections of 12 U.S.C. and 15 U.S.C.). The JOBS Act aims to facilitate investing and capital flow for small business startups in the United States. 126 Stat. at 306. The SEC is responsible for promulgating rules to regulate the business and investing practices sanctioned by the JOBS Act.

Congress were to preclude review for promulgations under Dodd-Frank, would that mean that it would only preclude review after a certain amount of time has elapsed so as to better gauge the difficulties faced by the agencies charged with the rulemaking or should Congress preclude review when enacting each Act? The very essence of the APA was to help tripartite government correctly manage itself and prevent any one branch of the federal government from overstepping its power. Were Congress to preclude review, then a whole sector of the balancing prescribed by the APA, namely, the judicial system, would be null and void, possibly negatively influencing the effectiveness of the federal government.

C. Codify Cost-Benefit Analysis

Given the importance of cost-benefit analysis in regulatory rulemaking, several advocates suggest that Congress should codify cost-benefit analysis requirements, which would effectively impose the same standards on all regulators.[406] In March of 2011, Senator Susan Collins introduced the Clearing Unnecessary Regulatory Burdens Act ("CURB"), which would statutorily impose requirements on agencies that are currently expressed in Executive Orders.[407] If an agency is found to be undertaking a "significant" regulatory action, CURB would require the agency to submit a detailed cost-benefit analysis to OIRA.[408] Furthermore, CURB would not only adopt measures detailed in previous Executive Orders, but would require agencies to undergo cost-benefit analysis when issuing legally nonbinding guidance documents.[409] While Senator Collins introduced the bill, Congress took no further action and the bill subsequently died in committee.[410]

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[406] *See* Katzen, *supra* note 23.

[407] Penn Program on Regulation, *Senate Bill Would Codify Benefit-Cost Analysis and Add Guidance Procedures*, REGBLOG (March 25, 2011), http://www.law.upenn.edu/blogs/regblog/2011/03/senate-bill-would-codify-benefit-cost-analysis-and-add-guidance-procedures.html.

[408] *Id.*

[409] *Id.* (detailing that "significant guidance documents" are those that will have an annual economic impact equal or greater to $100 million dollars, interfere with an agency's actions other than its own, "materially alter an entitlement," or create an original legal or policy issue).

[410] *See* Clearing Unnecessary Regulatory Burdens Act (2011; 112th Congress S. 602): Overview, GovTrack, http://www.govtrack.us/congress/bills/112/s602 (last visited Mar. 21, 2013).

Sally Katzen, a former Administrator of OIRA, has reservations about "codifying requirements and providing for judicial review of agencies' economic analysis."[411] Katzen suggests that codification would only be duplicative in nature since the requirements are already contained in executive orders, amend a "host of previously enacted statutes that either are silent on the role of costs in the formation of regulations or do not permit the consideration of such factors," and over-extend a judiciary to require it to make decisions that should remain with agencies.[412] Therefore, if Congress codified cost-benefit analysis, it might create a separation of powers issue by removing presidential power to limit applicable standards to be used by executive agencies.

D. Re-Organize the Agencies

1. SEC

Were the above actions not effective in entitling the SEC to greater deference in rulemaking under Dodd-Frank, the SEC should attempt to comply with section 3(f) requirements as interpreted by the D.C. Circuit. Such compliance may be effectively obtained through the structural reorganization of the SEC and CFTC. Perhaps the most appropriate division of the SEC to begin with is RSFI. Because one of the purposes of RSFI is to assist other divisions in rule promulgation, part of RSFI may be re-organized to specifically ensure proper analysis of regulations to meet section 3(f) requirements. Staffed with economists, lawyers and mathematicians, this new division would be well-rounded and appropriately suited to provide advice for satisfying section 3(f) requirements of major and controversial rules. In fact, in the SEC's guidance to rule writing staff, the SEC states that a primary goal in creating RSFI was "to enhance the agency's economic analysis capabilities for rulemaking."[413] To effectuate this goal, the SEC believes that the

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[411] Katzen, *supra* note 23.

[412] *Id.*; *see also* Sec. and Exch. Comm'n v. Chenery Corp. (*Chenery II*), 332 U.S. 194, 202–03 (1947) (detailing that to extent possible, courts should not second guess agency decisions regarding internal procedures; instead courts should give deference to allocation of internal agency resources if reasonable in nature).

[413] Memorandum from the SEC Division of Risk, Strategy, and Fin. Innovation & Office of the Gen. Counsel to Staff of the SEC Rulewriting

close collaboration between rule writing staff and RSFI economists will result in more thought out and developed rule proposals and therefore they should be involved at the earliest stages and throughout the rulemaking process.[414]

However, as it would be implausible for a single division to review every promulgated rule, the SEC would need to create a system in which immaterial and inconsequential rules would be precluded from RSFI's review. As transaction costs must be considered, were every material or contentious proposed rule to be reviewed by RSFI, it would quickly become more and more difficult for the regulators in RSFI to adequately write, explain or advise on the adequacy of the rules' consistency with section 3(f) requirements. Lawyers tasked with writing and promulgating rules in other divisions are not likely to be well-versed in economics, and similarly, economists likely lack legal expertise to draft the specific language used in rulemakings. This creates transaction costs in learning the concerns, purposes, and goals of each rulemaking. Presumably, each lawyer working on a specific promulgation acquires the most unique and specialized skill of the issues addressed in the rule. Relating this plethora of issues and gradations of concerns to an economist to ensure compliance with section 3(f) will not only take time but will surely result, to some degree, in information being "lost in translation."

Furthermore, as the SEC guidance promotes, RSFI economists should "attend meetings with commenters or other third parties regarding the proposed rule, particularly in those instances when the rule writing team expects that the outside party will provide additional data or comment upon the economic analysis or data contained in the proposing release."[415] However, this practice may place a greater strain on the resources of RSFI staff to not only aid

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Divs. and Offices (Mar. 16, 2012), *available at* http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf (last visited Aug. 6, 2012).

[414] *Id.* (believing that close collaboration "will help to . . . (1) assist in the evaluation of different or competing policy options by identifying the major economic effects of those options; (2) influence the choice, design, and development of policy options; (3) assist in the evaluation of whether and to what extent any proposed policy would promote efficiency, competition, and capital formation; (4) improve the quality of regulation; (5) better support policy choices made by the Commission; and (6) increase confidence in the regulatory process").

[415] *Id.*

lawyers in the drafting of the proposed releases, but to also aid rule writing staff in this role throughout the adoption process. Therefore, hiring or re-assigning lawyers who have an economic background may be the best way to address such an issue, as they are able, with greater effectiveness and minimal cost, to bridge the informational gap and ensure compliance with section 3(f) requirements.

2. CFTC

Similar to the SEC, the CFTC has also recently undergone structural reorganizations in its rulemaking teams to improve the efficacy of cost-benefit analysis. As mentioned in Section V, the CFTC recently required that a staff person from the Office of the Chief Economist be placed on each rulemaking team.[416] This move sought to improve the quality of economic analysis of CFTC rulemakings.[417] Simply requiring each rulemaking team to include a staff person from the Office of the Chief Economist, however, may not go far enough.

Perhaps one of the greatest improvements that can be made at the CFTC, like the SEC, is to increase the number of lawyers with economic backgrounds on rulemaking teams. Simply adding more economists or adding more lawyers to rulemaking teams will not appropriately address the problem. Instead, attempts must be made to intertwine all the members of each rulemaking team so that they can speak a common language and work together to achieve a quality final rule with a solid cost-benefit analysis. Adding more individuals to the team with varying degrees of expertise might sound good in theory; however, the lack of a common understanding of what cost-benefit analysis entails (such as a result that might stem from adding individuals without similar educational foundations in economics) might prevent these teams from achieving ultimate success.

One comparative advantage that the CFTC possesses in terms of changing its organizational structure is its relative youth when compared to other federal agencies.[418] Consequently, the CFTC is better positioned to adapt and accept change because its staff is not

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[416] *See* Office of the Inspector General, *supra* note 277, at iii.
[417] *Id.*
[418] *See* Wendy L. Gramm & Gerald D. Gay, *Leading a Regulatory Agency: Lessons from the CFTC*, 17 CATO REG., no. 4, Fall 1994, at 64, 66, *available at* http://www.cato.org/pubs/regulation/regv17n4/reg17n4d.html.

as entrenched as other agencies.[419]

E. Hope for Change in the D.C. Circuit

Historically, in deciding agency interpretations and actions, the D.C. Circuit has been less deferential than regional circuit courts.[420] One of the proposed explanations is that the D.C. Circuit is well versed in such issues; this allows its members to gain a comparative advantage in understanding such issues.[421] Additionally, as many of the Supreme Court Justices are nominated from the D.C. Circuit, judges therefrom are incentivized to decide cases in a manner which is celebrated by their political affiliation, thus creating a niche in their political party come time for judicial nominations.[422] Therefore, one possible solution to overcome the recent decisions by the D.C. Circuit would be to require the Commission to simply wait until there is a favorable change in the composition of the court.

VII. Conclusion

Cost-benefit analysis is a tool designed to bring transparency to a process that is often heavily criticized as overly political and rushed. It is meant to foster careful consideration of the consequences of choosing a certain regulatory path over another. However, when there is uncertainty as to how the process should unfold and what it must entail, the burden it creates far outweighs any potential benefit it seeks to provide.

The current reality is that the SEC and CFTC have no framework on which to rely when conducting cost-benefit analysis in rulemakings. While the recent D.C. Circuit decisions in *American*

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[419] *Id.* ("The CFTC is easier to run than many other agencies because its iron triangle has not fully 'solidified.' First, the agency is relatively young. This means that the staff is not as deeply entrenched as those of other regulatory agencies and thus is not as reluctant to consider new ideas or different procedures.").

[420] Richard J. Pierce, Jr., *What Do the Studies of Judicial Review of* Agency *Actions Mean?*, 63 ADMIN. L. REV. AM. U. 77, 90 (2011) (concluding that D.C. Circuit upholds agency regulations 10–15% less often than regional courts).

[421] *Id.* (proposing that because D.C. Circuit has a competitive advantage, the court is able to focus on comprehension of issues and facts and not be concerned with understanding basic proper agency procedures).

[422] *Id.* at 91.

Equity, *Chamber of Commerce*, and even *Business Roundtable* provide some insights into what an adequate cost-benefit analysis must contain, they do not provide a usable methodology to agency regulatory attorneys. Either Congress, the judiciary, or the agencies themselves must provide more definite guidance to rulemaking teams so that they may support promulgation of rules under Dodd-Frank in stalwart cost-benefit analysis. The need for such guidance is even greater for the CFTC as it attempts to create physical markets and oversee a swaps industry that has never been truly regulated.

Dodd-Frank is designed "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."[423] While cost-benefit analysis seeks to provide transparency to the process of creating rules, it will continue to be used by financial reform opponents as a tool to undermine each rule that seeks to bring such transparency to the financial system. Coincidentally, a greater transparency and elucidation of the requirements of an adequate cost-benefit analysis will yield viable long-term rules that have a chance to achieve the financial reform that Senator Chris Dodd and Congressman Barney Frank sought to achieve when proposing this landmark legislation.

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[423] Dodd-Frank Act, Pub L. No. 111-203, 124 Stat. 1376, 1376.